"obligee."[665] To label the incurrence of an obligation a "transfer," therefore, is the equivalent of mixing an apple and an orange.

Sometimes, a principle is so basic to the fabric of bankruptcy law that it is difficult to find a case stating the obvious, but on the rare occasion when courts have paused to consider the point, they have recognized that an obligation and transfer are not the same thing.[666] Regrettably, two courts blurred the distinction between these concepts, although the references were passing and the opinions are unlikely to be followed in this context (or any other when the distinction between a transfer and an obligation actually would make a difference).[667]

Because section 546(e) itself contains no other definition of the term "transfer," the logical conclusion is that this term means the same in that section as it does elsewhere in the Bankruptcy Code.[668] By its terms, therefore, section 546(e) only protects transfers, as defined in

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[665] 11 U.S.C. § 548(c) (2006).

[666] *Covey Commercial Nat'l Bank*, 960 F.2d 657, 661 (7th Cir. 1992) ("Although a note or guarantee is not a 'transfer' for purposes of 11 U.S.C. § 101(54), both note and guarantee are obligations (internal citations omitted); *Asia Global Crossing*, 333 B.R. at 204 (stating that a guaranty is a "chose in action" and incurrence of such liability does not constitute a "transfer" within the meaning of Bankruptcy Code section 101(54)); *In re Garden Ridge*, 323 B.R. 136, 141 (Bankr. D. Del. 2005) ("The code does not specifically define 'obligation,' however, the Third Circuit held that 'the most straightforward understanding of an obligation is something that one is legally required to perform under the terms of the lease and that such an obligation arises when one becomes legally obligated to perform.'") (citing *Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holdings Corp.)*, 268 F.3d 205, 209 (3d Cir. 2001)). The distinction has been recognized under other federal statutes as well. *See Wolkowitz v. FDIC (In re Imperial Credit Indus., Inc.)*, 527 F.3d 959, 971-73 (9th Cir. 2008) (applying 12 U.S.C. § 1828(u)(1) to resolve the question whether that statute applied to "obligations" and rejecting such contention).

[667] *See Belfance v. Buonpane (In re Omega Door Co.)*, 399 B.R. 295, 304 (B.A.P. 6th Cir. 2009) (applying Ohio law and only analogizing to Bankruptcy Code); *In re Taubman*, 160 B.R. 964, 982 (Bankr. S.D. Ohio 1993) (finding that "false profits" payments made by debtor in Ponzi scheme constituted transfers of the debtor's property under the Bankruptcy Code, where by "checks, cashier's check, or by transfer of other property, including real estate conveyances as well as the incurrence of obligations pursuant to promissory notes and agreements").

[668] *See Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932) ("[T]here is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning."); *Comm. of Equity Sec. Holders of Fed.-Mogul Corp. v. Off. Comm. of Unsecured Creditors (In re Fed. Mogul-Global, Inc.)*, 348 F.3d 390, 407 (3d Cir. 2003) ("It is well established that 'identical words used in different parts of the same act are intended to have the same meaning.'") (citations omitted). Although no rule of construction, let alone this one, is dispositive, it would be illogical to assume that Congress intended a different meaning for the term "transfer" in section 546(e) without specifying a different definition of the term in that section. *See* 11 U.S.C. § 101 (2006) ("In this title the following definitions shall apply . . . .").

the Bankruptcy Code, from the avoidance actions enumerated in that provision. Moreover, there is no principled distinction between the delivery of the check in *Barnhill* and the delivery of promissory notes and guarantees here. There was no transfer at the time of delivery in *Barnhill* and thus there is no transfer at the time of delivery of the promissory notes and guarantees here. Because an obligation is not protected under the plain language of the statute, an action to avoid an obligation as a fraudulent transfer should remain viable notwithstanding section 546(e).

This analysis also addresses the status of the Stock Pledge, which of course is a "transfer" within the meaning of Bankruptcy Code section 101(54). A security interest, however, is only as valid as the obligation it secures, and a lien that secures no obligation is a nullity. Stated otherwise, an "avoided obligation is rendered unenforceable."[669] A claim unenforceable against the debtor and its property therefore cannot be an "allowed claim" or a "secured claim" within the meaning of the Bankruptcy Code.[670] The security has no remaining status in the bankruptcy case. Thus, although a lien is a form of transfer, as is a payment, the lien's continued validity depends on the validity of the obligation it secures. This is in contrast to a settlement payment, which is fully effectuated when made and, in any event, expressly protected under section 546(e). Unlike a lien securing an obligation or a promissory note evidencing one, a transfer constituting a payment is not rendered void if the obligations satisfied by such payment are avoided: the transfer itself must be avoided and then recovered.[671] The Stock Pledge here only existed to secure the obligations under the Credit Agreement and is meaningless except as

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669 *Asia Global Crossing*, 333 B.R. at 202.

670 11 U.S.C. § 502(b)(1) (2006) (a claim is not allowed if it "is unenforceable against the debtor and property of the debtor"); § 506(a)-(b) ("[t]o the extent that an *allowed secured claim* is secured by property, the value of which . . . .") (emphasis added); § 506(d) ("[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void . . . ."); *see also Dewsnup v. Timm*, 502 U.S. 410, 416 (1992).

671 *See* 11 U.S.C. § 548(a)(1) (2006) (distinguishing between avoidance of obligations and transfers). *See also Enron Corp. v. Bear, Stearns Int'l, Ltd.*, 323 B.R. 857, 877 (Bankr. S.D.N.Y 2005) (finding section 546(e) settlement payment defense not available if underlying obligations are void, but distinguishing between a void and voidable obligation).

security for the Credit Agreement Debt. If the Credit Agreement Debt is avoided, the Stock Pledge secures nothing. In sum, section 546(e) affords no protection for the Credit Agreement Debt or any security, promissory notes, or guarantees given in connection therewith. A very different conclusion would follow had section 546(e) been drafted to cover not just transfers but obligations.

The preceding statutory construction nevertheless may be criticized for rendering the 2006 amendments to section 546(e) *per se* inoperative as applied to transfers in favor of lenders "in connection with" a leveraged buyout transaction involving a securities transaction, thereby allegedly violating the very rule of statutory construction used to unravel this defense in the first place: namely, that every provision of a statute must be given effect.[672] So the criticism goes: avoiding an obligation under section 548 would render the very transfer (*i.e.*, the liens securing that obligation, and any promissory notes given) a nullity, notwithstanding the protection that section 546(e) provides and the supremacy of that protection over the avoidance provisions enumerated in that section. The Examiner emphatically disagrees with this critique. Assuming for the sake of argument that section 546(e) applies to extensions of credit in leveraged buyout transactions, the conclusion that the statute does not protect avoidable obligations incurred to those lenders (or liens securing them) does not render the 2006 amendments superfluous. Applying the plain language, section 546(e) protects a transfer notwithstanding the fact that such transfer might otherwise be avoidable under the enumerated avoidance provisions, but it offers no protection for the underlying obligation. What this means is that if a transfer that is protected under section 546(e) is made on account of an *unavoidable* obligation, the transfer is sacrosanct. If not, it is not.

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[672] *See* footnote 654.

The following illustration makes the point concretely: Suppose "in connection with" a leveraged buyout and securities transaction, the lender advancing the funds to cash out existing stockholders successfully insists that the debtor secure both the new advances and the lender's unsecured preexisting debt. The debtor files bankruptcy within 90 days of the transfer. The transfer on account of the preexisting debt is avoidable as a preference under Bankruptcy Code section 547, but as long as the *obligation* that was secured is unavoidable—and again provided the other prerequisites to section 546(e) are satisfied—under its plain terms, section 546(e) protects the transfer against avoidance. Section 546(e) takes primacy over avoidance under section 547, but if that transfer is on account of an avoidable obligation, section 546(e) affords no protection because the transfer is only as valid as the obligation it continues to secure: if the obligation is avoided, the lien falls on its own accord by application of the avoidance statute, sections 502 and 506, and general nonbankruptcy law. To the extent the obligations are avoided, therefore, section 546(e) offers no protection.[673] As the language of section 546(e) is plain and the legislative history gives no reason to deviate from the statute's plain meaning,[674] there is no basis on which to deviate from these conclusions.

The Examiner concludes that it is reasonably unlikely that a court would find that section 546(e) affords the protection that certain of the LBO Lenders assert. Because the Examiner finds

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673 A separate question arises whether, if the other predicates to application of section 546(e) are met here, payments made to certain LBO Lenders on LBO Fees at the time of the Leveraged ESOP Transactions would be recoverable if the underlying obligations and liens are subsequently avoided. The Parties did not present, and therefore the Examiner expresses no opinion on, this question. Instead, the Parties only presented the question whether section 546(e) protects the obligations incurred to the LBO Lenders.

674 *In re Lehman Bros. Holdings, Inc.*, 2010 Bankr. LEXIS 1260, at *25-26 (Bankr. S.D.N.Y. May 5, 2010) (noting the technical nature of the amendments implemented by the act). The contention of certain Parties that the Congress' intent in the 2006 amendments was to avoid the "systemic risks" faced by financial institutions that make credit extensions for purposes of enabling borrowers to redeem stock, or for other transactions involving settlement payments, is rank speculation.

that element (1) of the above-noted argument is lacking, there is no need to consider the remaining components.

(2) Examiner's Conclusions and Explanation Concerning the Question of a Section 546(e) "Work-Around."

Examiner's Conclusions:

Questions concerning the viability of potential mechanisms whereby individual creditors or a creditor trust may assert causes of action otherwise insulated from recovery under Bankruptcy Code section 546(e) are outside the scope of the Investigation.

Explanation of Examiner's Conclusions:

Certain Parties contended that, whether directly or by analogy, the estates could abandon to individual creditors and/or vest in a creditor trust established under a plan of reorganization the rights to pursue fraudulent transfer claims that might otherwise be protected under Bankruptcy Code section 546(e). Relinquishment of the claims allegedly would enable individual creditors to assert state law fraudulent transfer claims unburdened by section 546(e),[675] whereas establishment of a creditor trust under a plan would allow for a single representative to amalgamate and prosecute these claims. Certain other Parties argued that these mechanisms could not be accomplished consistent with law.[676] Because Question One solely encompasses "potential claims and causes of action held by the Debtors' estates" and does not

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675 *See generally In re Haugen Constr. Serv., Inc.*, 104 B.R. 233, 240 (Bankr. D.N.D. 1989) (stating that trustee has discretion to utilize remedies provided for in the Bankruptcy Code avoidance provisions and in determining whether to pursue such actions trustee must consider factors such as "the factual and legal merits of the prospective action; the probable value of the recovery to the estate; the probable cost of the action to the estate"); *In re V. Savino Oil & Heating Co.*, 91 B.R. 655, 656 (Bankr. E.D.N.Y. 1988) ("[A] trustee or debtor-in-possession has a substantial degree of prosecutorial discretion to sue or not to sue.").

676 *See, e.g., In re R-B-Co.*, 59 B.R. 43, 45 (Bankr. W.D. La. 1986) ("The Court does not believe that abandonment can be used, as a means of effecting a transfer of title, even if placed in the Plan of Reorganization. Under section 554, upon abandonment, the trustee or debtor-in-possession is simply divested of control of the property because it is no longer property of the estate.").

fairly include commenting on what might or might not be included in a plan of reorganization not yet on file, the Examiner refrains from opining on these matters.

b. Good Faith Defenses at Step One and Step Two.

(1) Bankruptcy Code Section 548—The Legal Standard.

Examiner's Conclusions:

A court is highly likely to adopt an objective test for good faith under Bankruptcy Code section 548 and measure good faith at the time the Tribune Entities incurred the obligations subject to challenge.

Explanation of Examiner's Conclusions:

Whether considered in the "totality of circumstances," in the determination of reasonably equivalent value under Bankruptcy Code section 548(a)(1), or, more properly, in assessing a defense to avoidance under section 548(c),[677] the good faith of each transferee must be evaluated. Courts have adopted different tests and approaches to measure good faith.[678] Although the Third Circuit Court of Appeals has not specifically addressed the standard in applying section 548, in *Wasserman v. Bressman (In re Bressman)*,[679] a case involving the closely-analogous consideration of good faith under Bankruptcy Code section 550(b)(1),[680] the court endorsed the

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677 *See* Report at § IV.B.5.b.

678 *See In re Telesphere Commc'ns, Inc.*, 179 B.R. 544, 557 (Bankr. N.D. Ill. 1994) ("Moreover, the courts have varied widely in the general approach they have taken in deciding questions of good faith in the context of fraudulent conveyance law."); *Brown v. Third Nat'l Bank (In re Sherman),* 67 F.3d 1348, 1355 (8th Cir. 1996) ("Good faith is not susceptible of a precise definition and is determined on a case-by-case basis.").

679 327 F.3d 229 (3d Cir. 2003).

680 11 U.S.C. § 550(b)(1) (2006) (defense for subsequent transferee "that takes for value . . . , in good faith, and without knowledge of the voidability of the transfer avoided.").

now widely-accepted standard adopted by the Eighth Circuit Court of Appeals under section 548(c):[681]

> No one supposes that knowledge of voidability means complete understanding of the facts and receipt of a lawyer's opinion that such a transfer is voidable; some lesser knowledge will do. Accordingly, we believe that a transferee has knowledge if he knew facts that would lead a reasonable person to believe that the property transferred was recoverable. In this vein, some facts suggest the underlying presence of other facts. If a transferee possesses knowledge of facts that suggest a transfer may be fraudulent, and further inquiry by the transferee would reveal facts sufficient to alert him that the property is recoverable, he cannot sit on his heels, thereby preventing a finding that he has knowledge. In such a situation, the transferee is held to have knowledge of the voidability of the transfer.

Under the "objective" test for measuring good faith, the court determines "what the transferee knew or should have known 'such that a transferee does not act in good faith when it has sufficient knowledge to place it on inquiry notice of the voidability of the transfer.'"[682] "[A] transferee cannot stick its head in the sand, clinging to its subjective belief while purporting to

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[681] 327 F.3d at 236-37 (quoting *In re Sherman*, 76 F.3d 1348, 1357 (8th Cir. 1995)) (internal citations and quotations omitted). *See also Chorost v. Grand Rapids Factory Showrooms, Inc*., 77 F. Supp. 276, 281 (D.N.J. 1948) (avoiding transfer because "the facts and circumstances of the transaction were sufficient to put the reasonably prudent person on inquiry"), *aff'd*, 172 F.2d 327 (3d Cir. 1949); *Shubert v. Premier Paper Prods., LLC (In re Am. Tissue*, *Inc.*), 2007 Bankr. LEXIS 4004, at *25 (Bankr. D. Del. Nov. 20, 2007) (stating that the Third Circuit has established that the "[good faith] defense is not available if the transferee has knowledge of facts that would lead a reasonable person to believe that the property was recoverable by a debtor").

[682] *See Roeder v. Lockwood (In re Lockwood Auto Grp., Inc.)*, 2010 Bankr. LEXIS 1377, at *12-13 (Bankr. W.D. Pa. May 14, 2010) (stating that "good faith is determined according to an objective or 'reasonable person' standard"); *Ameriserv Fin. Bank v. Commercebank, N.A.*, 2009 U.S. Dist. LEXIS 24559, at *25-26 (W.D. Pa. Mar. 26, 2009); *Dobin v. Hill (In re Hill)*, 342 B.R. 183, 203 (Bankr. D.N.J. 2006) (quoting *In re Burry*, 309 B.R. 130, 136 (Bankr. E.D. Pa. 2004)); *see also Jobin v. McKay (In re M&L Bus. Mach. Co.)*, 84 F.3d 1330, 1334, 1335-36 (10th Cir. 1996) ("The presence of any circumstance placing the transferee on inquiry as to the financial condition of the transferor may be a contributing factor in depriving the former of any claim to good faith unless investigation actually disclosed no reason to suspect financial embarrassment."); *Bayou Accredited Fund, LLC v. Redwood Growth Partners (In re Bayou Grp., LLC),* 396 B.R. 810, 844-45 (Bankr. S.D.N.Y. 2008) (concluding that federal courts have reached a consensus that "good faith" under the Bankruptcy Code provisions is determined according to an "objective" or "reasonable person" standard and not on the subjective knowledge or belief of the transferee, and that under this standard the courts look to what the transferee objectively 'knew or should have known'").

ignore signs of fraud or insolvency on the part of the transferor."[683] Thus, in *Brown v. Third National Bank (In re Sherman)*,[684] the court held that "a transferee does not act in good faith when he has sufficient knowledge to place him on inquiry notice of the debtor's possible insolvency."

"The presence of any circumstance placing the transferee on inquiry as to the financial condition of the transferor may be a contributing factor in depriving the former of any claim to good faith unless investigation actually disclosed no reason to suspect financial embarrassment."[685] "The rule does not require that the 'red flag' be of such specificity as to put the recipient on 'inquiry notice' of the actual fraud, or embezzlement, or looting, or whatever ultimately proves to be the cause of loss. It is sufficient if the red flag puts the investor on notice of some potential infirmity in the investment such that a reasonable investor would recognize the need to conduct some investigation."[686] "In order to prove 'good faith,' that 'diligent investigation' must ameliorate the issues that placed the transferee on inquiry notice in the first place."[687]

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683 *Moglia v. Universal Auto., Inc. (In re First Nat'l Parts)*, 2000 U.S. Dist. LEXIS 10420, at *19 (N.D. Ill. July 12, 2000); *see*, *also HBE Leasing Corp. v. Frank*, 48 F.3d 635, 637 (2d Cir. 1995) ("Under the circumstances, [transferee's] failure to inquire represented a conscious turning away from the subject.").

684 *Brown v. Third Nat'l Bank (In re Sherman)*, 67 F.3d 1348, 1355 (8th Cir. 1995).

685 *M & L Bus. Mach. Co.*, 84 F.3d at 1335 (quoting 4 COLLIER ON BANKRUPTCY ¶ 548.07[2] at 548-72 (Lawrence P. King ed., 15th ed. 1996)). The court in *Jobin* also noted that "a transferee does not act in good faith when he has sufficient knowledge to place him on inquiry notice of the debtor's possible insolvency." *Id.* at 1336 (citing *Sherman*, 67 F.3d at 1355). Under the objective test, however, the actual knowledge of the transferee is not rendered irrelevant. *See In re First Nat'l Parts Exch., Inc.*, 2000 U.S. Dist. LEXIS 10420, at *19-25 (N.D. Ill. July 12, 2000) (stating that a good faith analysis should weigh both subjective good faith and the objective basis for that good faith); *Bayou Grp.*, 396 B.R. at 849 ("[T]o disregard objective evidence of the transferee's subjective good faith intent would fundamentally distort the concept of good faith.").

686 *Bayou Grp.*, 396 B.R. at 848.

687 *Id.* at 846; *see also Lockwood Auto Grp., Inc.*, 2010 Bankr. LEXIS at *12-13 ("[O]nce a transferee is on notice of suspicious circumstances regarding a transfer, it is obliged to conduct a diligent investigation which must 'ameliorate' the issues that placed it on inquiry notice in the first place."); *Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.)*, 275 B.R. 641, 660 (Bankr. M.D. Fla. 2002).

As noted previously,[688] the good faith of a transferee or obligee is measured when the transfer is made or the obligation is incurred. Thus, for example, as discussed in another part of the Report, the Tribune Entities incurred the Step One obligations under the Credit Agreement at the closing of Step One when the funds were advanced and the Step Two obligations under the Incremental Credit Agreement Facility and Bridge Facility at Step Two when those funds were advanced.[689] These are the obligations that an estate representative would seek to avoid and as to which the respective LBO Lenders assert good faith defenses.

One nevertheless could argue that the Credit Agreement lenders gave value in connection with Step Two when they committed to fund Step Two in the Incremental Credit Agreement Facility (included in the Credit Agreement) executed on May 17, 2007 and that the Bridge Facility Lenders gave value when they similarly committed to fund Step Two in the Step Two Commitment Letter executed on April 5, 2007; and, therefore, good faith in connection with the Step Two advances should be measured at these earlier times and not when the Tribune Entities actually incurred the Step Two Debt in December 2007. The Examiner disagrees.

First, as the Examiner previously has found on the question of collapse of Step One and Step Two for solvency purposes,[690] the Tribune Entities did not incur any obligation to borrow money under the Incremental Credit Agreement Facility or the Step Two Commitment Letter when those documents were executed in connection with Step One. Those obligations were incurred when Step Two closed. If Step One and Step Two were collapsed for solvency purposes, it probably would be appropriate to measure lender good faith in connection with the Step Two Debt at the time of Step One, but the Examiner has found that a court is somewhat

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688 *See* text accompanying footnote 260.

689 *See* Report at § IV.B.5.d.(6).(i).

690 *See id.*

unlikely to collapse the two steps. One of the ripple effects from that conclusion is that questions of good faith must be measured at the times the obligations actually were incurred at each of Step One and Step Two respectively. As discussed previously,[691] the natural construction of Bankruptcy Code sections 548(a)(1) and (c) is that reasonably equivalent value and good faith are measured at the moment when the obligation is incurred and value is allegedly imparted.[692] Because the object of avoidance would be the incurrence of the obligations at Step Two, lender good faith is appropriately measured when the obligations were incurred.

Second, if an estate representative sought to avoid any obligations imposed or transfers made under the Incremental Credit Agreement Facility or under the Step Two Commitment Letter at the time of their execution, lender good faith certainly would be measured at the time of those undertakings. Thus, for example, had Tribune paid a separate commitment fee to the lenders making the commitments in the Step Two Commitment Letter and were an estate representative seeking to avoid and recover that payment, lender good faith would be measured at the time the value was imparted, i.e., when the Step Two Commitment Letter was executed.[693] But the "main event"[694] here is avoidance of the obligations to the LBO Lenders incurred at Step One and Step Two respectively, and it is the lender good faith at those times that is relevant.

Third, under the terms of the Incremental Credit Agreement Facility and the Step Two Commitment Letter, the lenders were not obligated to honor their commitments until the various conditions precedent specified in those credit agreements were satisfied. Ignoring those conditions precedent and how the lenders dealt with them as Step Two approached would be to

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691 *See* text accompanying footnote 260.

692 One might be tempted to say in this regard that the LBO Lenders cannot have it both ways, but in fairness, not all of the LBO Lenders argued to the Examiner against collapse of Step One and Step Two.

693 *See* Report at § IV.B.5.c.(6).

694 *See id.* at § IV.B.2.

disregard the events that culminated in the Tribune Entities' incurring and the lenders' advancing the Step Two Debt. It would be nonsensical to render irrelevant for good faith purposes the events that transpired after Step One giving rise to that massive indebtedness—especially when the Tribune Entities did not even incur that debt until Step Two.

This does not mean that the commitments made by the lenders at Step One regarding the Step Two funding are entirely irrelevant to questions of good faith. The objective test "look[s] at the actions of a reasonably prudent person in the transferee's position."[695] The Examiner considers the effect of these commitments on the question of good faith below.

The Examiner applies the objective standard in evaluating good faith under Bankruptcy Code section 548.[696]

(2) Examiner's Conclusions and Explanation Concerning Effect of Good Faith Determination Regarding Credit Agreement Agent and Bridge Agent on Obligations Incurred Under Those Agreements—Whose Good Faith Matters?

Examiner's Conclusion:

A court is highly likely to find that any lack of good faith by the Credit Agreement Agent or the Bridge Facility Agent at the time the respective obligations under these facilities were

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[695] *Jobin v. Ripley (In re M&L Bus. Mach. Co.)*, 198 B.R. 800 (D. Colo. 1996), *aff'd*, 84 F.3d 1330 (10th Cir. 1996); *Dev. Specialists, Inc. v. Hamilton Bank, N.A. (In re Model Imperial, Inc.)*, 250 B.R. 776 (Bankr. S.D. Fla. 2000).

[696] *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986), does not compel a different conclusion. There, in applying Pennsylvania's UFTA, the court noted that "knowledge of insolvency is a rational interpretation of the statutory language of lack of 'good faith.'" *Id.* at 1295. The court also approved consideration of other factors, including "1) honest belief in the propriety of the activities in question; 2) no intent to take unconscionable advantage of others; and 3) no intent to, or knowledge of the fact that the activities in question will, hinder, delay, or defraud others." *Id.* at 1296. The court approved the lower court's finding of lack of good faith, noting that the court "determined that IIT did not act in good faith because it was aware, first, that the exchange would render Raymond insolvent, and second, that no member of the Raymond Group would receive fair consideration." *Id.* As the lower court found that the lender there had actual knowledge of the debtor's insolvency, there was no reason for the appellate court to consider whether the lender acted in bad faith based upon an objective test. *Id.*

incurred will apply to all claims issued under such facilities, whether those claims are in the hands of original holders or their successors.

Explanation of Examiner's Conclusion:

The lenders under the Credit Agreement and the Bridge Facility each appointed their respective agent to take actions on their behalf.[697] To the extent those agents manifested a lack of good faith for fraudulent transfer purposes, the consequences for those actions do not just begin and end with them. "[K]nowledge acquired by an agent acting within the scope of the agency is imputed to his principal, and the latter is bound by such knowledge although the information is never actually communicated" to the principal.[698] The presumption underlying the imputation rule is that "an agent has discharged his duty to disclose to the principal all the material facts coming to [the agent's] knowledge with reference to the subject of his agency."[699] A principal, moreover, cannot disclaim the actions of its agent if all of the principal's benefits—the obligations and liens that they hold—are critically dependent on the very acts they would like to disclaim.[700]

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697 *See* Ex. 179 at § 7.01 (Credit Agreement); Ex. 175 at § 7.01 (Bridge Credit Agreement).

698 *See Ctr. v. Hampton Affiliates, Inc.*, 488 N.E.2d 828, 829 (N.Y. 1985). Because all credit facilities are governed by New York law, New York agency law applies; s*ee Annan v. Wilmington Trust Co. Tr.*, 559 A.2d 1289, 1293 (Del. 1989) ("Delaware courts will recognize a choice of law provision if the jurisdiction selected bears some material relationship to the transaction.").

699 *Hampton Affiliates*, 488 N.E.2d at 829; *see also Evvtex Co. v. Hartley Cooper Assocs.*, 102 F.3d 1327, 1332 (2d Cir. 1996) ("[A]n agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have . . . .") (internal quotation marks and citations omitted).

700 *Matanuska Valley Bank v. Arnold*, 223 F.2d 778, 781 (9th Cir. 1955) ("But assuming that Maze was acting adversely to appellant, his principal, his knowledge should nevertheless be imputed to appellant under the sole actor doctrine."); *Conn. Fire Ins. Co. v. Commercial Nat'l Bank*, 87 F.2d 968, 969 (5th Cir. 1937) ("The transaction of the unfaithful agent may indeed be not binding on his principal in the sense that because of fraud the principal can repudiate or rescind it, but if he elects to retain its specific results to the detriment of a third person justice requires that he take the transaction with its actual infirmities. . . . When authority to do the act is present, every agent fully represents his principal in that act. And when the act is done by an agent of any class and advantage is claimed under it there can be no question of the authority to do it."); *Munroe v. Harriman*, 85 F.2d 493, 495 (2d Cir. 1936) ("The truth is that where an agent, though ostensibly acting in the business of the principal, is really committing a fraud, for his own benefit, he is acting outside of the scope of his agency, and it would therefore be most unjust to charge the principal with knowledge of it."). But the injustice disappears if

The answer is the same whether the lender is an original holder or a transferee. Citing *Enron Corp. v. Springfield Associates, LLC (In re Enron Corp.)*,[701] one Party asserted that any lack of good faith of the Credit Agreement Agent cannot avoid or disallow the claim of a "good faith" transferee under the Credit Agreement, alleging that they acquired their claims through "purchase" of rights under the Credit Agreement and that lack of good faith is a "personal disability" of the Credit Agreement Agent. But even assuming the correctness of the *Enron* decision and its distinction between sales and assignments,[702] and even accepting that the relevant transactions were denominated as a "purchase and sale," *Enron* should have no applicability to avoidance of claims and liens as fraudulent obligations and transfers. *Enron* dealt with the court's ability to equitably subordinate a claim in the hands of a transferee whose transferor had been guilty of inequitable conduct. The *Enron* court concluded that equitable subordination was a "personal disability,"[703] affixed to the holder of a claim rather than to the claim itself. But fraudulent transfer (or preference) law is different and operates directly to avoid the underlying obligation or transfer regardless of who holds the claim:[704]

> [A]voidability is an attribute of the transfer rather than of the creditor. Since it is the transfer, not the [creditor], that is avoided,

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the principal adopts the unauthorized act of his agent in order to retain a benefit for himself. *See In re S. Afr. Apartheid Litig.*, 633 F. Supp. 2d. 117, 121-22 (S.D.N.Y. 2009) ("The acts of an agent are imputed to the principal if the principal adopts the unauthorized act of his agent in order to retain a benefit for himself. Even mere acquiescence is sufficient to infer adoption of wrongdoing.") (internal quotations marks and citations omitted); *Irving Trust Co. v. State Bankers' Fin. Corp.*, 40 F.2d 88 (S.D.N.Y. 1930) ("Where an agent engages in a fraudulent transaction of which his principal receives the fruits, the principal, if he insists upon retaining the benefits of the transaction, is chargeable with the knowledge of his agent.").

701 379 B.R. 425 (S.D.N.Y. 2007).

702 The decision has been criticized. WILLIAM L. NORTON, III & ROGER G. JONES, NORTON CREDITORS' RIGHTS HANDBOOK § 8:8 ("The court never explains the difference between an assignment and a sale, and the case law does not bear out the distinction."); Tally M. Wiener & Nicholas B. Malito, *On the Nature of the Transferred Bankruptcy Claim*, 12 U. PA. J. BUS. L. 35, 49-51 (2009) (criticizing decision's distinction between sales and assignments). Moreover, no court has cited the opinion for this distinction or the holding that equitable subordination is a personal disability.

703 379 B.R. at 439-40.

704 *H & C P'ship v. Va. Serv. Merchandisers*, 164 B.R. 527, 530 n.4 (E.D. Va. 1994) (citing *Levit v. Ingersoll Rand Fin. Corp. (In re Deprizio)*, 874 F.2d 1186, 1195 (7th Cir. 1989)) (internal quotations and citations omitted).

> the creditor's only relief from liability or "recoverability" is governed by § 550(a). Contrary to H & C's assertions, avoidability and recoverability are distinguished by the application of the *Deprizio* rule. Avoidability of the transfer is governed by § 547. Section 550, then, answers the question of from whom the trustee may recover.

As the Supreme Court recognized in the preference context: [705]

> The § 547 determination, standing alone, operates as a mere declaration of avoidance. That declaration may be all that the trustee wants; for example, if the State has a claim against the bankrupt estate, the avoidance determination operates to bar that claim until the preference is turned over. See § 502(d). In some cases, though, the trustee, in order to marshal the entirety of the debtor's estate, will need to recover the subject of the transfer pursuant to § 550(a). A court order mandating turnover of the property, although ancillary to and in furtherance of the court's in rem jurisdiction, might itself involve in personam process.

The fact that a party may be an assignee, "purchaser," or the like of a portion of bank debt may—as *Enron* suggests—affect questions of equitable subordination (depending on the manner in which that debt is transferred and other courts' willingness to adopt the *Enron* holding), but that should have no bearing on avoidance. That is not to say that good faith of transferees is irrelevant in the fraudulent transfer context. Far from it. When avoidance does not suffice under Bankruptcy Code section 548, section 550 comes into play, and issues such as good faith, acquisition for value, and lack of knowledge by the subsequent transferee of the transfer's voidability all are on the table. Those matters, however, never arise when the underlying transfer is avoided without resort to section 550.[706]

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[705] *Cent. Va. Cmty. College v. Katz*, 546 U.S. 356, 371-72 (2006).

[706] *See Coleman v. Cmty. Trust Bank (In re Coleman)*, 426 F.3d 719, 726 (4th Cir. 2005) ("[N]o recovery [is] necessary; the avoidance itself [is] the meaningful event. . . . Thus, the recovery statute [§ 550] has no application here."); *Glanz v. RFJ Int'l Corp. (In re Glanz)*, 205 B.R. 750, 758 (Bankr. D. Md. 1997) (same); H.R. Rep. No. 95-595 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 6331 ("Section 550 prescribes the liability of a transferee of an avoided transfer, and enunciates the separation between the concepts of avoiding a transfer and recovering from the transferee."). Section 550, on the other hand, expressly addresses who are the proper defendants to a fraudulent transfer cause of action by specifically identifying three different potential types of defendants (initial transferees, beneficiaries, and subsequent [a/k/a mediate or immediate] transferees). *See* 11 U.S.C. §§ 550(a), (d) (2006).

(3) Examiner's Conclusions and Explanation Concerning Good Faith of JPMCB as Credit Agreement Agent at the Time Obligations Incurred at Step One and Step Two.

Examiner's Conclusions:

A court is reasonably likely to conclude that JPMCB acted in good faith in connection with the obligations incurred and advances made in the Step One Transactions but did not act in good faith in connection with the obligations incurred and advances made in the Step Two Transactions.

Explanation of Examiner's Conclusions:

The evidence supports the conclusion that JPMCB acted in good faith in connection with the Step One Transactions. First, the Examiner separately has concluded that, absent collapse, it is highly likely that the Step One Transactions did not render the Tribune Entities insolvent or without adequate capital. Thus, even if the JPMCB were placed on inquiry notice that Step One might render Tribune insolvent or without adequate capital, an inquiry into the actual facts and circumstances would lead a reasonable prospective lender in JPMCB 's position to conclude that the Tribune Entities would not be rendered insolvent. Second, market-based information available to the JPMCB at the time the Tribune Entities incurred the Step One Debt supported the conclusion that the Step One Transactions would not render the Tribune Entities insolvent.[707] Third, contrary to certain Parties' contentions, the contemporaneous e-mails and analyses generated by JPM personnel do not support the inference that these people knew or reasonably believed that the Step One Transactions would render the Tribune Entities insolvent,[708] nor is there credible evidence that JPMCB improperly was motivated by fee generation or its relationship with Samuel Zell. Finally, contrary to certain Parties' contentions, there is no

[707] *See* Report at § IV.B.5.d.(7).

[708] *See id.* at § III.E.4.a.

reasonable basis to conclude that JPMCB (or the other Lead Banks) acted in bad faith regarding the repayment of the 2006 Bank Debt. Although it is true that the 2006 Bank Debt did not have recourse to the Guarantor Subsidiaries, whereas the Credit Agreement Debt did, the aggregate pre-Step One indebtedness was substantially lower than the total post-Step One Debt at the Guarantor Subsidiary and Tribune levels. It is implausible that the lenders who held 2006 Bank Debt viewed the Credit Agreement Debt as a material improvement in their overall position. Even if they did, the Examiner finds nothing improper in the repayment of this indebtedness at Step One. For reasons discussed elsewhere in the Report,[709] repayment of the 2006 Bank Debt was required absent waiver and would be expected in a transaction in which mostly the same lenders made new advances under a transaction that radically changed the Tribune Entities' capital structure.

Because the Examiner has found that it is reasonably likely that a court would find that JPMCB as Credit Agreement Agent acted in good faith in connection with the obligations incurred and advances made in the Step One Transactions, this means that, even if the prerequisites to avoidance of the Step One Debt are otherwise met, the Credit Agreement Agent and the lenders under the Credit Agreement should be entitled to enforce those portions of the obligations incurred by such Tribune Entity for which such Tribune Entity received reasonably equivalent value, as discussed previously in the Report.[710]

The Examiner reaches a different conclusion, however, concerning the good faith of JPMCB in connection with the Step Two Transactions. Based on the record, the Examiner concludes that JPMCB and the other Lead Banks had sufficient knowledge to be placed on

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[709] *See id.* at § IV.B.4.b.

[710] *See id.* at § IV.B.5.c.

inquiry notice regarding Tribune's possible insolvency as Step Two approached.[711] Those indicia included, among other things, the highly-leveraged nature of the Leveraged ESOP Transactions (which would be magnified by a Step Two Closing and the addition of the Step Two Debt to the balance sheet),[712] the deterioration in Tribune's operating performance in the months following Step One,[713] the decline in Tribune's Common Stock price as well as certain of its debt instruments during this same period, the tightening in the credit markets during the summer and leading into the fall of 2007, and the difficulties the Lead Banks were facing in syndicating the LBO Lender Debt. Moreover, the fact that the Lead Banks, acting together through jointly retained counsel, determined in the fall of 2007 to retain Murray Devine, a valuation advisory firm, to assist in the banks' due diligence concerning Tribune's insolvency demonstrates that the question of Tribune's solvency as Step Two approached is tangible evidence that the Lead Banks not only were on inquiry notice, but were inquiring.[714]

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711 *See Brown v. Third Nat'l Bank (In re Sherman)*, 67 F.3d 1348, 1355 (8th Cir. 1995).

712 Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 74:8-11 ("Q: We have seen very little in the documents that have been provided to suggest that a similar analysis was being done in step one. Do you recall whether such an analysis was done? A: It's highly likely that it wasn't given that the leveraging effects of step one were far less dramatic than step two, which was on top of step one."). *See also* Ex. 868 (Kaplan E-Mail dated August 11, 2007) ("Idea is not to increase interest (cash is flat at $125 per annum per bond), but to allow increased principal amount to improve noteholders claim in a reorg type analysis."); Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 46: 9-16 (Q: "What did you mean by 'reorg type analysis?' Are you talking about a bankruptcy reorganization? A: Without remembering exactly what I was writing at the time, I must have been referring to some sort of downside event like a bankruptcy reorganization.").

713 Examiner's Sworn Interview of Julie Persily, July 8, 2010, at 76:1-14 ("Q: Excuse me. At the end of 2007. Thank you. When there is a lot of thought being given to that issue, did it occur to you that advertising revenue was going to be adversely impacted by what was happening in the economic marketplace at the time? A. I don't remember exactly what I thought. It occurred to me that this company was in more trouble than we thought it was when we first signed the deal. We'd be stupid not to know that, but I was much more focused on, I mean we were not going to be able to sell the second step debt. We were going to have to own it.").

714 Ex. 969 (Murray Devine Engagement Letter, dated October 1, 2007); Ex. 974 (Kenny E-Mail, dated October 2, 2007) ("Raj from JPM called and would like to have a talk with us on Thursday or Friday morning with a smaller group. He specifically wants our input on the VRC opinion and presentation and to educate them on valuation methods and how they apply in solvency opinions. He mentioned discount rate calculations[,] the weightings of methods, etc.").

Under the objective test for good faith, discussed previously,[715] "[i]f a transferee possesses knowledge of facts that suggest a transfer may be fraudulent, and further inquiry by the transferee would reveal facts sufficient to alert him that the property is recoverable, he cannot sit on his heels, thereby preventing a finding that he has knowledge. In such a situation, the transferee is held to have knowledge of the voidability of the transfer."[716] Having been placed on inquiry notice, therefore, JPMCB and the other Lead Banks not only had a duty to investigate the facts, but are charged with the knowledge that a creditor reasonably would have obtained after due inquiry.[717] The Examiner finds that had JPMCB and the other Lead Banks conducted that inquiry, they would have reasonably determined that the Step Two Transactions would render Tribune insolvent. Not only did compelling market indicia lead directly to this conclusion,[718] but more traditional valuation metrics pointed to insolvency as well.[719] Applying the objective test for good faith, JPMCB and the other Lead Banks should have known that the Step Two Transactions would render Tribune insolvent and, therefore, it is reasonably likely that they cannot be found to have acted in good faith in connection with the Step Two Transactions. The Examiner, however, considered the actions of JPMCB and the other Lead Banks in the period preceding the Step Two Closing, and evaluated four mitigating factors bearing on good faith:

First, the Examiner considered the fact that JPMCB as well as the other Lead Banks did not make a new credit decision at Step Two, but rather, honored their contractual obligations made at Step One. There is an element of unfairness in applying the same standard to JPMCB and the other Lead Banks for good faith purposes that would be applied to a lender not operating

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715 *Sherman*, 76 F.3d at 1357 (citations omitted).

716 *Id.*

717 *See* footnotes 679-687.

718 *See* Report at § III.H.3.f.(4).

719 *See id.* at § IV.B.5.d.(10).

under a preexisting contractual obligation, but who determines to advance money knowing that the borrower will be rendered insolvent. Indeed, a fair inference may be drawn from the evidence that, had they had the opportunity, JPMCB (and probably most or all of the other LBO Lenders for that matter) would have gladly declined to fund Step Two.[720] Although the Examiner is not without sympathy for the predicament that the Lead Banks found themselves in at Step Two, the Examiner concludes that this circumstance does not change his conclusion on good faith conclusion. Neither JPMCB nor the other Lead Banks made unconditional commitments under the Step Two Commitment Letter. Although the Step Two Commitment Letter did not expressly condition the Lead Banks' Step Two funding obligations under that letter on Tribune's solvency, those obligations were conditioned on the negotiation, execution, and delivery of definitive Step Two Financing Documents, in customary form, presumably meaning that the definitive Step Two Financing Documents would include a solvency requirement mirroring the solvency requirement embodied in the Credit Agreement entered into by the Lead Banks at Step One.[721] The Credit Agreement contained a representation that Tribune would be "Solvent" (as defined in the Credit Agreement) on consummation of the Step Two Transactions,[722] the truth of which was a condition to the funding under the Incremental Credit Agreement Facility. The Bridge Credit Agreement similarly required the delivery of a solvency certificate and the accuracy of representations (including the solvency definition).[723] Thus, whether or not Tribune delivered a solvency certificate and managed to procure a solvency

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[720] *See id.* at § III.H.4; *see also* Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 85:13-15 ("I think it's fair to say it would have been better for us to not close economically, absolutely.").

[721] Ex. 1010 at 3 and 5 (Amended Step Two Commitment Letter).

[722] Ex. 179 at § 4.01(1)(l)(ii) (Credit Agreement).

[723] Ex. 175 at § 3.01(b)(i) and (iv)(A) (Bridge Credit Agreement).

opinion, JPMCB and the other Lead Banks were not obligated to fund if Tribune's solvency representation was false.

As sophisticated lenders, JPMCB and the other Lead Banks undoubtedly were aware that refusing to fund if Tribune presented a solvency opinion, a solvency certificate, and a solvency representation would have lead to litigation and, possibly, the imposition of substantial damages.[724] The Examiner infers from the record that, as a matter of litigation risk management, the Lead Banks apparently determined that, in order to refuse to fund at Step Two, they would need more than just a belief that Tribune would be rendered insolvent: The Lead Banks determined to fund rather than fight. However, the fact that the Lead Banks made what may have made a rational decision from a litigation perspective (if only from the point of view that it is better to risk fraudulent transfer litigation down the line than face immediate breach of contract litigation and the rupturing of lending relationships with Tribune, EGI, and Samuel Zell), should not insulate them from the burden imposed under the objective test for good faith. To benefit from the good faith defense, JPMCB could not advance funds to Tribune if a reasonable creditor would have known that doing so would render Tribune insolvent. The lenders' own loan documents conditioned their funding obligation on Tribune's solvency and thus these agreements are generally consistent with what the good faith standard requires. Although, as noted previously,[725] these agreements did contain a definition of "Solvent" at odds with the definition of that term under the law, the Examiner does not believe that the law permits a party,

[724] Although the Credit Agreement contained a waiver of consequential damages, Ex. 179 at § 8.04(b) (Credit Agreement), the allegations of actual damages undoubtedly would have been significant.

[725] *See* footnotes 87 and 539 and accompanying text.

by private contract, to adopt a standard of solvency at variance with what the law provides, and then apply that standard, in effect, to modify the good faith standard.[726]

Second, the Examiner considered the fact that JPMCB and the other Lead Banks asked and posed follow-up questions to Tribune (and, through Tribune, VRC), requested and obtained information from Tribune regarding its business performance and projections, and, as noted, retained Murray Devine to assist them in connection with these efforts.[727] Although this evidence shows that JPMCB and the other Lead Banks did not put their collective heads in the sand, the Examiner does not find that their efforts were sufficient to move the Lead Banks into good faith terrain. Significantly, the Lead Banks did not retain *and never asked* Murray Divine to opine on solvency or to issue a solvency report.[728] Instead, as set out in its engagement letter, Murray Devine was retained to provide guidance "as to the methodologies and analyses which may be used by *another* firm in preparing a solvency opinion . . . in connection with the Transaction."[729] This was not an oversight: The Examiner asked representatives of each of the four Lead Banks whether they asked Murray Devine to assess Tribune's solvency. Witnesses for all four Lead Banks agreed that Murray Devine was not asked to assess Tribune's solvency, but rather was retained to assist the lenders in understanding VRC's solvency analysis. JPM's Rajesh Kapadia explained that the banks only "needed to get smarter and . . . educated around the solvency process," but did not want or need a de novo assessment of Tribune's solvency because (according to Mr. Kapadia) the condition precedent to the banks' obligations was the CFO's

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726 *See generally In re Pease*, 195 B.R. 431, 435 (Bankr. D. Neb. 1996) ("I conclude that any attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable.").

727 *See* Report at §§ III.H.3.g.(10). and III.H.4.(b).

728 *See id.* at § III.H.4.b.(1); *see also* Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 97:4-9.

729 Ex. 969 at 1 (Murray Devine Engagement Letter, dated October 1, 2007) (emphasis added); *see also* Ex. 970 (Murray Devine Time Records) (reflecting the relatively narrow scope of work performed by Murray Devine).

certification of solvency—not the lenders' own assessment of solvency.[730] Todd Kaplan of MLCC testified that "Murray Devine was asked to give us background as to how . . . solvency opinions were developed and rendered"—not to actually render a solvency opinion itself.[731] Similarly, when Citicorp's Julie Persily was asked whether Citicorp "ask[ed] Murray Devine to advise you whether the second stage closing would render Tribune insolvent," she responded: "We didn't ask the question that way. We asked . . . how do you develop a solvency opinion, what do you look at?"[732] Daniel Petrik of BofA explained "that [the arrangers] discussed this internally and viewed that we did not need another solvency opinion, but we wanted to . . . understand [VRC's] solvency opinion."[733]

Had the Lead Banks requested and obtained a valuation from Murray Devine or other qualified third party, and had that valuation tenably shown Tribune solvent, their case for good faith might have been more tenable. It is evident from the record, however, that the scope of Murray Devine's work (indeed its very retention by counsel) was driven by potential litigation considerations. Once again, JPMCB and the other Lead Banks may have made a rational decision from the perspective of litigation management to limit what Murray Devine was asked to do. But for the same reason noted above, that decision does insulate them from the requirements of good faith. Indeed, viewed through the prism of good faith, the limitations

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730 Examiner's Interview of Rajesh Kapadia, June 25, 2010.

731 Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 101:13-102:20; *see also id.* at 97:17-21 ("Murray Devine was brought in as an expert in the field of delivering solvency opinions, and that expertise was our attempt to learn more about how solvency opinions were developed and rendered."); *id.* at 104:2-105:11 ("[I]f we as a lending group in the August, September, October time frame had decided gee, it would be nice to have a solvency opinion, that was too late [because] we didn't have any ability to garner access to the company for a solvency expert to render an opinion.").

732 Examiner's Sworn Interview of Julie Persily, July 8, 2010, at 167:4-13.

733 Examiner's Sworn Interview of Daniel Petrik, July 8, 2010, at 146:15-18. *See also id*. at 145:5-8 ("[T]he underwriters talked about whether we need someone to help us understand, someone that would be more of an expert to help us understand VRC's work.").

imposed on Murray Devine's work has more in common with willful blindness than the kind of due diligence sufficient to meet the good faith standard.[734]

Third, the Examiner considered information adduced concerning discussions among the Lead Banks during this timeframe as well an analyses produced from JPM's files, and the files of Merrill, Citigroup, and BofA, containing various internal solvency analyses performed by those institutions in November and December of 2007.[735] Notes that Mr. Petrik of BofA took from a December 14, 2007 conference call among the Lead Banks are illuminating not only as to what the Lead Banks were thinking about during that timeframe, but also some of their views on the question of solvency.[736] Mr. Petrik's notes, which are reproduced verbatim in another Section of the Report,[737] appear to set forth the views at the time of each of the Lead Banks on the question whether to fund at Step Two:

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[734] The record supports the inference that VRC's work was viewed skeptically even at the end. Notes from a December 17, 2007 conference call among the Lead Banks reference the following statement by a Citgroup representative on the call: "S Corp savings WRONG but still +hv PHONES." Ex. 890 (Handwritten Notes of JPMCB Representative).

[735] *See* Report at §§ III.H.4.b.(2).-III.H.4.b.(5).

[736] Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007).

[737] *See* Report at § III.H.4.b.(1).

Word Product

12/14/07 - UW call
- Need VRC info today and discuss Monday
- If D date - change entries to NYS to Employees

Chris JPM - Not 100% final but leaning
Going ahead and funding
Risk greater if do not fund

MRL - Not 100% but leaning to not fund
- Reasonable that not a solvent company
- Not planning on being lone wolf

Julie Citi - Numerous and not significant to not fund
- More risk if end up in bankruptcy
- Focus on understanding risk of not funding
- Not yet landed -

BofA - Tom Briggin Bill Bower
- Lynn S. Dan Kelly
Rajin, Dan P., [illegible]

If in good faith - good defense

The Examiner became aware of the contents of Mr. Petrik's notes after all Lead Bank interviews had concluded, shortly before the deadline for filing the Report.[738] Accordingly, the

[738] On or about June 10, 2010, the Examiner's financial advisor, LECG, received a letter from Sidley Austin, LLP, counsel for the Debtors, enclosing a disk containing 474 documents (13,233 pages) produced by Bank of America and BAS. Sidley Austin, LLP, advised LECG that this disk was produced in response to document requests propounded on Bank of America and BAS by WFB and Wilmington Trust. On or about June 17, 2010, these documents were uploaded and available for review through a database accessible only to the Examiner and those working on his behalf in this Investigation.

Included within this production were some handwritten pages with the words "Word Product" written at the top. To the best of the Examiner's knowledge, the late evening of July 13, 2010 is the first time that anyone working on his behalf accessed the pages of the production that contained these notations. On July 14, 2010, at 6:26 pm ET, counsel for the Examiner sent a letter via e-mail to counsel for BofA advising him of the existence of these pages and asking BofA to advise: (1) the identity of the author of these pages; (2) whether the disclosure of these documents was inadvertent; and (3) whether BofA deems these pages confidential. On July 15, 2010, at 11:13 am ET, counsel for BofA responded that these pages were written by BofA banker Daniel Petrik, that these pages were inadvertently produced, and requested that the Examiner return the pages or certify their destruction and not reference them in any way. On July 15, 2010 at 11:28 am ET, counsel for the Examiner spoke with counsel for counsel for BofA telephonically at which time counsel for BofA confirmed that a document bearing Bates number BOA-TRB-0001201, which contains a handwritten notation "Word Product" was not attorney work product. Counsel for BofA also confirmed that he had spoken with Mr. Petrik and that,

Examiner was not able to question the participants about the information contained in those notes or confront witnesses with inconsistencies between these notes and their prior (in some instances sworn) statements to the Examiner. The question presented in this Section of the Report solely is whether JPMCB and the other Lead Banks are entitled to a good faith defense for purposes of the fraudulent transfer statute. Whether these entities acted in bad faith and, if so, whether their actions would justify equitable subordination of the LBO Debt, are questions addressed in another part of the Report.[739]

The internal analyses of solvency prepared by JPM and the other Lead Banks provide additional backdrop against which the Lead Banks approached the question of funding. Interestingly, JPM did not provide any e-mail correspondence or any memoranda accompanying these internal valuation analyses. Indeed, the Examiner did not find a single e-mail referencing these analyses.[740] The latest of these, dated December 18, 2007, calculates Tribune's net equity value under a range of "stress," "low," "mid," and "high" valuations.[741] This analysis suggests Tribune is insolvent only under a "stress" case, is barely solvent under a "low" case, and is substantially solvent under the "mid" and "high" cases. As discussed in more detail elsewhere in

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to the best of his recollection, there were no attorneys present during the telephone conversation which is reflected in Mr. Petrik's handwritten notes on the document bearing Bates number BOA-TRB-0001201. Nevertheless, counsel for BofA advised that BofA viewed this document as attorney-client privileged because the speakers in the telephone conversation reflected in Mr. Petrik's notes were communicating attorney-client privileged information. At 1:30 pm ET, counsel for the Examiner telephoned counsel for BofA and asked him to reconsider BofA's assertion of attorney-client privilege with respect to this document and requested that BofA allow the Examiner to cite the document in the Report. At 6:27 pm ET, counsel for BofA informed counsel for the Examiner that BofA would provide the Examiner with a fully unredacted version of BOA-TRB-0001201 and that the Examiner could use the information in the document in the Report free of any assertion of privilege or confidentiality. BofA maintained that portions of the rest of the production are privileged and were inadvertently produced. BofA thereupon produced redacted versions of the documents included in this production. *See* footnote 939.

739 *See* Report at § IV.D.3.a.

740 *See id.* at § III.H.4.b.(2).

741 *See id.*

the Report,[742] relatively modest adjustments in this analysis (such as eliminating the net present value of the anticipated S-Corporation/ESOP tax savings and removing the upward bias caused by high comparable transactions valuations) result in insolvency by a small margin in the mid case and a large margin in the low and stress cases, and solvency only in the high case. It is also notable that JPM appears to have added a fourth case—the "stress" case—at precisely the point that its various internal analyses began showing insolvency in the low case. As discussed in another part of the Report,[743] although the Examiner is not able to determine the order in which each analysis bearing the same date was prepared, the overall trend of the analyses from December 10, 2007 to December 18, 2007 appears to suggest that projected insolvency in the low case led JPM to add a fourth case (the stress case) to reflect the insolvency scenario, with modifications to the low case such that it once again reflected solvency (albeit thin).

When questioned about these internal analyses during his interview with the Examiner, Mr. Kapadia could not recall the intended audience for which they were prepared, but he believed the analyses were merely a continuation of JPM's Step Two solvency diligence.[744] Mr. Kapadia stated that he did not believe JPM's diligence in the week prior to the Step Two Financing Closing Date was shared with senior executives such as James Lee or Jamie Dimon, nor did Mr. Kapadia believe that JPM was using these internal solvency analyses to make a final decision whether to close.[745] To the contrary, and generally consistent with the view apparently expressed by JPM on the December 14, 2007 lender conference call that the "risk [was] greater if [the banks] do not fund,"[746] albeit with far different spin, Mr. Kapadia indicated that "in practice,

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742 *See id*.

743 *See id.*

744 Examiner's Interview of Rajesh Kapadia, June 25, 2010.

745 *Id.*

746 Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007).

people don't go up to the 11th hour and not close the deal. This is not like we're . . . diligencing to get out of the deal."[747]

For their part, as discussed further below, the analyses performed by Merrill, Citigroup, and BofA show insolvency under various posited scenarios,[748] and are consistent with the sentiment expressed by Merrill on the December 14, 2007 lender conference call.[749] Whether or not any of the analyses prepared by the Lead Banks in the period shortly before the Step Two Closing represented the views of these institutions on valuation, the evidence is abundant that these institutions knew or had reason to know that the case for insolvency was, to say the least, closer than VRC had opined. Particularly in light of witness testimony that their institutions did not have the in-house capacity to perform a solvency valuation,[750] at a minimum these analyses support the conclusion that the Lead Banks should have retained their own outside solvency expert if they wished to make the case for good faith under these circumstances.

Fourth, the Examiner considered the events described earlier in the Report[751] regarding statements by Tribune to JPMCB and the other Lead Banks concerning Morgan Stanley's involvement in Tribune's representation that it would be able to refinance its debt when it came due and in evaluating VRC's solvency opinion. As discussed previously, among other things, it appears that during a December 17, 2007 conference call involving Tribune and the Lead Banks (but apparently not Morgan Stanley), the Lead Banks were told that Morgan Stanley had

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747 Examiner's Interview of Rajesh Kapadia, June 25, 2010.

748 *See* Report at §§ III.H.4.b.(2)., III.H.4.b.(4)., and III.H.4.b.(5).

749 Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007).

750 Examiner's Interview of Rajesh Kapadia, June 25, 2010; Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 34:17-21 ("I would say that beginning, again, if I could use in August as generalized around that time frame, we at Merrill Lynch realized that we had essentially no in-house solvency expertise at all.").

751 *See* Report at §§ III.H.3.g.(10) and IV.C.2.

reviewed VRC's opinion and determined that it was fair and reasonable.[752] The Examiner finds that the statements, which appear to have been made by Tribune to the Lead Banks, as well as Tribune's statements regarding Morgan Stanley's role in the refinancing representation and in VRC's solvency opinion, mitigate somewhat against a finding that JPMCB and the other Lead Banks failed to act in good faith in connection with the Step Two Transactions. These statements did furnish some basis for the Lead Banks to accept Tribune's solvency certificates and representations, and made it incrementally more difficult for JPMCB and the other Lead Banks to contest Tribune's position regarding insolvency. On the other hand, the record does not indicate that the Lead Banks ever contacted Morgan Stanley directly,[753] and Tribune never produced to the banks any analysis purporting to substantiate the views ascribed to Morgan Stanley. Moreover, the record supports the inference that the Lead Banks funded based on their own assessment of their litigation exposure if they did not fund, taking into account their contractual obligations and the litigation risks, not what was said on that call. Although the statements made on the December 17, 2007 conference call should not be condoned, and as discussed in another part of the Report, tend to support the conclusion that Tribune acted at Step Two with intent to hinder, delay, or defraud creditors, they do not, for purposes of applying Bankruptcy Code section 548(c), overcome the contrary evidence pointing to JPMCB's and the other Lead Banks' lack of good faith.

Because the Examiner finds, following due consideration of various mitigating factors, that it is reasonably likely that a court would find that JPMCB as Credit Agreement Agent did not act in good faith in connection with the obligations incurred and advances made in the Step

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[752] Ex. 890 (Handwritten Notes of JPMCB Representative).

[753] Mr. Kapadia had no recollection whether he ever spoke to Morgan Stanley about its involvement in the refinancing representation. Examiner's Interview of Rajesh Kapadia, June 25, 2010.

Two Transactions, the Credit Agreement Agent and the lenders under the Credit Agreement should not be entitled to enforce any portion of the obligations incurred at Step Two under the good faith defense.[754]

(4) Examiner's Conclusions and Explanation Concerning Good Faith of JPM Entities as Transferee of LBO Fees at Step One and Step Two.

The Examiner finds no basis to vary the conclusions reached above concerning JPMCB's actions as Credit Agreement Agent from the actions of the JPM Entities as recipients of LBO Fees at both steps. As a result, the Examiner finds that it is reasonably likely that the JPM Entities acted in good faith in Step One but not in Step Two, and that they should be entitled to the good faith defense as to some portion of the LBO Fees paid at Step One but not at Step Two.

(5) Examiner's Conclusions and Explanation Concerning Good Faith of MLCC as Bridge Credit Agreement Agent at the Time Obligations Incurred at Step Two.

For reasons very similar to the Examiner's rationale for his conclusion concerning JPMCB as Credit Agreement Agent, the Examiner finds that it is reasonably likely that a court would conclude that MLCC did not act in good faith as Bridge Credit Agreement Agent in connection with the obligations incurred and advances made in the Step Two Transactions.

As noted above and discussed at length in another part of the Report,[755] the Lead Banks (including the Merrill Entities) acted essentially in concert in their efforts to address VRC's solvency analysis and the question of solvency in general. The Examiner finds no basis to reach any different good faith conclusions concerning MLCC, as Bridge Credit Agreement Agent, than he did regarding JPMCB as Credit Agreement Agent at Step Two. As discussed elsewhere in the

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[754] *See* Report at § IV.B.5.b. and footnote 848.

[755] *See id.* at § III.H.4.

Report, [756] Merrill's own internal analyses generally showed that Tribune would be rendered insolvent at Step Two in "mid" and "low" cases. Todd Kaplan, the Chairman of Global Leverage Finance at Merrill, testified, however, that "this is not a Merrill Lynch valuation analysis. This is, as I recall and as I look at it today, our attempt to understand how VRC was developing their work and providing an opinion to the Company to satisfy the closing condition."[757] Mr. Kaplan repeatedly disclaimed knowledge about the calculations and assumptions underlying these analyses, and testified that he would not consider any of them to be "a Merrill Lynch Valuation analysis"[758]—notwithstanding that each is printed on Merrill stationary and bears the title "Valuation Analysis of Tribune Company." Mr. Kaplan further testified that he could not recall whether he or any of the other bankers working on the transaction had reservations about closing:[759]

> Q. Did you have any reservations at that time about closing step two?
>
> A. I don't recall. My particular feelings were I do know that we were working hard to ascertain whether or not the transaction was going to close, but beyond that I don't recall what my particular feelings were at that time.
>
> Q. Were you having discussions at that time . . . with the other lenders?
>
> A. Yes.
>
> Q. Did any of the other lenders express to you that they had reservations about closing step two?
>
> A. I don't recall.

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[756] *See id.* at § III.H.4.b.(3).

[757] Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 155:2-7.

[758] *Id.* at 155:2-3.

[759] *Id.* at 40:15-41:7.

Mr. Kaplan's lack of recollection aside, the documentary evidence reflects Merrill's concern that Tribune would be rendered insolvent at Step Two.[760] As noted above, handwritten notes of the lender call that took place six days before Step Two closed appear to reflect Merrill's belief that Tribune was "not a solvent company," but that Merrill was "not planning on being [the] lone wolf" that did not close.[761] Merrill was on the same inquiry notice as JPMBC and is charged with the same knowledge as JPMCB under the objective test for insolvency, and, for the reasons discussed above in reference to JPMCB, the Examiner concludes is not entitled to a good faith defense.

Because the Examiner has found that it is reasonably likely that a court would find that MLCC, as Bridge Credit Agreement Agent, did not act in good faith in connection with the Step Two Transactions, the Bridge Credit Agreement Agent and the lenders under the Bridge Credit Agreement should not be entitled to enforce any portion of the obligations incurred at Step Two under the good faith defense.

(6) Examiner's Conclusions and Explanation Concerning Good Faith of Merrill Entities as Transferee of LBO Fees at Step One and Step Two.

Regarding the LBO Fees paid to the Merrill Entities at Step One, for reasons similar to the Examiner's conclusions concerning the good faith of JPMCB and MLCC as agents at Step

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760 On July 16, 2010, the Examiner's counsel received from Merrill's counsel what purports to be a "corrected" transcript of Mr. Kaplan's July 8, 2010 sworn interview with the Examiner, containing numerous multi-paragraph additions to the sworn testimony Mr. Kaplan gave on July 8. Ex. 976 (Letter from Jane W. Parver, dated July 16, 2010). Beyond the fact that these extensive additions are different in kind from every other errata sheet submitted in connection with the Examiner's sworn interviews, and appear to contradict Mr. Kaplan's sworn testimony that he had no recollection of key events, documents, and circumstances, the Examiner notes that Mr. Kaplan's "corrected" transcript was sent one day after the Examiner's counsel notified counsel to BofA (whom the Examiner understands contacted counsel for the other Lead Banks) that the Examiner was in possession of the handwritten notes described in the text, Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007), discussed in the Report. The Examiner makes the "corrected transcript" part of the record of the Investigation, but does not accord it any weight.

761 Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007). The above-excerpted portion of Mr. Kaplan's testimony is not credible, nor were other aspects of Mr. Kaplan's sworn interview.

One, the Examiner finds that it is reasonably likely that a court would find that the Merrill Entities acted in good faith in its capacity as transferee of LBO Fees at Step One. Merrill appears to have made a credit decision to provide financing for the Zell bid based on its analysis of this credit's characteristics as Step One approached.[762] Although Merrill had been involved in transactions with Mr. Zell in prior years and Mr. Kaplan had done business with Mr. Zell since 1986 (and was offered a job by Mr. Zell in March 2008),[763] the Examiner found nothing to suggest that Merrill participated as a lender for any reasons other than to profit in that capacity.

Regarding the LBO Fees paid to Merrill at Step Two, however, the Examiner finds no basis to vary the conclusions reached above concerning MLCC's actions as Bridge Credit Agreement Agent from the actions of the Merrill Entities as recipients of LBO Fees at Step Two, and, therefore, finds that it is reasonably likely that a court would conclude that the Merrill Entities did not act in good faith in connection with Step Two.

(7) Examiner's Conclusions and Explanation Concerning Good Faith of Citigroup Entities as Transferee of LBO Fees at Step One and Step Two.

Regarding the LBO Fees paid to the Citigroup Entities at Step One, for reasons similar to the Examiner's conclusions generally regarding lender good faith at Step One, the Examiner finds that it is reasonably likely that a court would conclude that the Citigroup Entities acted in good faith in their capacity as transferee of LBO Fees at Step One. The Examiner, again, found no basis to conclude that the Citigroup Entities had any motive other than to generate profit in their capacities as lenders to Tribune.[764]

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762 *See* Report at § III.E.4.b.

763 Examiner's Sworn Interview of Todd Kaplan, July 8, 2010, at 64:22-66:13.

764 *See* Report at § III.E.4.c.

Regarding the LBO Fees paid to the Citigroup Entities at Step Two, however, the Examiner likewise finds no basis to vary, as to the Citigroup Entities, from the conclusions reached above concerning the good faith of the JPM Entities and the Merrill Entities as recipients of LBO Fees at Step Two. Julie Persily, Managing Director, Head of North America Leveraged Finance at Citigroup, testified that the various analyses prepared by Citigroup in the late fall of 2007 represented a "bust case or a breaking case," and did not represent Citigroup's views on fair market value. [765] Whether or not this is plausible, however, at a minimum, these analyses demonstrate that Citigroup was on inquiry notice concerning Tribune's insolvency. Indeed, as discussed in the Report,[766] two days before the lender conference call on which Ms. Persily apparently expressed the view that it might be less problematic "to not fund" rather than risk a Tribune bankruptcy,[767] Citicorp apparently attempted to retain its own outside advisor to assess Tribune's solvency, but did not end up doing so. Considered in light of the other indicia of insolvency, discussed above, and for the reasons discussed above in reference to JPM and Merrill, the Examiner believes that a court is reasonably likely to conclude that the Citigroup Entities did not act in good faith in connection with Step Two.

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[765] Examiner's Sworn Interview of Julie Persily, July 8, 2010, at 192:1-14; 201:20-21. Ms. Persily testified that the fact that certain of the cases showed negative equity did not mean that Tribune was insolvent. *Id.* at 196:20-197:11 (Q: And why do you draw a distinction between negative equity and not necessarily insolvent? A: Because there are very many solvent companies that have negative equity and as we learned through this process there are a lot of ways to value solvency and one of them is ability to meet commitments when they become due in the near term one year, two years out and this company had a very big revolver and it had a lot of asset sales, assets which we knew there was third party interest in and so we believed that this company was going to have access to liquidity for quite some time.").

[766] *See* Report at § III.H.4.b.(4).

[767] Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007).

(8) Examiner's Conclusions and Explanation Concerning Good Faith of BofA Entities as Transferee of LBO Fees at Step One and Step Two.

Regarding the LBO Fees paid to the BofA Entities at Step One, for reasons similar to the Examiner's conclusions generally regarding other lender good faith at Step One, the Examiner finds that it is reasonably likely that a court would conclude that the BofA Entities acted in good faith in their capacity as transferee of LBO Fees at Step One. Daniel Petrik (the Credit Products Officer on the transaction for BofA)[768] testified candidly that, although the funding opportunity offered BofA in the spring of 2007 failed to meet five of the ten criteria used by the bank to make credit decisions, the bank determined to proceed because of its ongoing relationship with Samuel Zell, the Tribune name and brand, and the "overall return on the risk."[769] BofA performed due diligence before making its financing commitment.[770] The Examiner finds no plausible evidence of bad faith.

Regarding the LBO Fees paid to the BofA Entities at Step Two, however, the Examiner finds no basis to vary, as to the BofA Entities, from the conclusions reached above concerning the good faith of the JPM Entities, the Merrill Entities, and the Citigroup Entities as recipients of LBO Fees at Step Two. Although Mr. Petrik testified that BofA prepared enterprise valuation analyses for Tribune's broadcasting and publishing businesses after Step One, he did not recall what those analyses showed.[771] When asked whether "Bank of America [had] done an internal analysis [in the fall of 2007] to determine whether Tribune's assets exceeded its liabilities," Mr.

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768 Examiner's Sworn Interview of Daniel Petrik, July 8, 2010, at 19:18-20:2. *See also id.* at 23:8-11 ("I stayed very involved through closing of Step 2 [and] I am also now responsible for monitoring the revolving line of credit and the relative risk to our institution.").

769 *Id.* at 64:13-65:18.

770 *See* Report at § III.E.4.d.(1) and III.E.4.d.(5).; Examiner's Sworn Interview of Daniel Petrik, July 8, 2010, at 83:22-85:17.

771 Examiner's Sworn Interview of Daniel Petrik, July 8, 2010, at 103:3-105:7.

Petrik responded: "I don't think so."[772] BofA's Leveraged Finance Screening Committee did, however, receive at least two updates from the deal team prior to the Step Two Financing Closing Date: on August 3, 2007[773] and December 13, 2007.[774] These memoranda listed an "enterprise value" for Tribune that was apparently based on work done by the bank's Enterprise Valuation Group, and encompassed only Tribune's operating assets.[775] The calculated enterprise values on August 3, 2007 and December 13, 2007 were $8.2 billion and $12.3 billion, respectively.[776] Total debt following Step Two was estimated on both dates to be $12.233 billion, which of course was substantially below the actual amount of debt Tribune was left with on the close of Step Two.[777]

In light of the indicia of insolvency then available to BofA and the other Lead Banks, discussed above, and for the reasons discussed above in reference to JPM, the Examiner believes that a court is reasonably likely to conclude that the BofA Entities did not act in good faith in connection with Step Two.

(9) Examiner's Conclusions and Explanation Concerning Good Faith of MLPFS and CGMI as Transferees of Advisor Fees at Step One and Step Two.

Examiner's Conclusions:

A court is somewhat likely to conclude that both MLPFS and CGMI acted in good faith in connection with the payments made to them as Advisor Fees in connection with the Leveraged

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772 *Id.* at 146:19-22. *See also id.* at 124:2-9.

773 Ex. 927 (Leveraged Finance Committee Update Memo, dated August 3, 2007).

774 *Id.*; Ex. 966 (Leveraged Finance Committee Update Memo, dated December 13, 2007).

775 Examiner's Sworn Interview of Daniel Petrik, July 8, 2010, at 103:8-105:1.

776 Ex. 927 at BOA-TRB-0013163 (Leveraged Finance Committee Update Memo, dated August 3, 2007); Ex. 966 at BOA-TRB-0007609 (Leveraged Finance Committee Update Memo, dated December 13, 2007).

777 Ex. 927 at BOA-TRB-0013164 (Leveraged Finance Committee Update Memo, dated August 3, 2007); Ex. 966 at BOA-TRB-0007611 (Leveraged Finance Committee Update Memo, dated December 13, 2007).

ESOP Transactions, although the question is closer regarding payments made following the Step Two Transactions to CGMI.

Explanation of Examiner's Conclusions:

The Examiner found no credible evidence that either MLPFS or CGMI lacked good faith in connection with the Step One Transactions. Both MLPFS and CGMI were actively engaged in working with the Tribune Board and its other advisors from at least October 2005 and October 2006, respectively.[778] During their involvement and prior to the close of Step One, both MLPFS and CGMI questioned the VRC opinion and obtained what they believed were satisfactory answers.[779] Notably, while engaged, the advisors even outlined the appropriate methodology—involving sales of assets (e.g., the Chicago Cubs, Tribune Tower) whose retention was not justified by their earnings—that could improve Tribune's liquidity.[780]

The conclusion at Step Two is not as obvious, but is probably the same. As contemplated in the letters engaging MLPFS and CGMI,[781] lending affiliates of these two advisors participated in financing the Leveraged ESOP Transactions. Between the close of Step One and Step Two, the credit markets began to tighten with the consequence that, as discussed above, the terms on which other Merrill and Citigroup Entities agreed to extend financing had become advantageous

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[778] MLPFS' familiarity with Tribune went back at least to 2000, although its retention for what became the Leveraged ESOP Transactions occurred by letter agreement dated October 17, 2005. Examiner's Interview of Michael Costa, June 4, 2010. There is no evidence of involvement by CGMI prior to September 21, 2006, as noted in its engagement letter dated October 27, 2006. Ex. 360 at 5 (CGMI Engagement Letter, dated Oct. 27, 2006).

The question of the good faith of MLPFS and CGMI at Step One is addressed here only because Tribune did make some relatively small payments at Step One to those entities in their capacities as Financial Advisors to Tribune.

[779] Examiner's Interview of Christina Mohr, June 29, 2010.

[780] *Id.*

[781] Ex. 24 at 4 (MLPFS Engagement Letter, dated Oct. 17, 2005); Ex. 360 at 4 (CGMI Engagement Letter, dated Oct. 27, 2006).

to Tribune but disadvantageous to the lenders.[782] To address the fact that MLPFS and CGMI might have a conflict (insofar as it could be in the best interests of their lending affiliates if MLPFS and CGMI recommended against closing Step Two), MLPFS and CGMI ceased providing advisory services in connection with the Leveraged ESOP Transactions.[783] There is no evidence that MLPFS or CGMI engineered their departure for any improper purpose, and neither the existence of conflicting roles or the cessation of activities by MLPFS or CGMI constituted a breach of any duty owed to the Tribune Entities.[784] Although both MLPFS and CGMI were aware that Tribune's performance had weakened and that the market for leveraged loans had tightened,[785] and although there is evidence that their respective lending affiliates had serious questions concerning Tribune's solvency,[786] there is no evidence that either MLPFS or CGMI knew that Step Two would leave the Tribune Entities insolvent or undercapitalized.[787]

The record does indicate that, as of late November 2007, CGMI (which had maintained the financial model used by Tribune to develop its projections) assisted Tribune management in updating its financial model with the assistance of junior CGMI personnel.[788] This assistance

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782 Examiner's Interview of Christina Mohr, June 29, 2010; Examiner's Interview of Michael Costa, June 4, 2010.

783 Examiner's Interview of Michael Costa, June 4, 2010. *Cf.* Examiner's Interview of Christina Mohr, June 29, 2010.

784 The engagement letters, as noted, contemplated conflicting roles. Moreover, the advisors expressly disclaimed any fiduciary relationship. Ex. 24 at 3 (MLPFS Engagement Letter, dated Oct. 17, 2005); Ex. 360 at 4 (CGMI Engagement Letter, dated Oct. 27, 2006). Those disclaimers are valid under applicable (New York) law. *See Seippel v. Jenkens & Gilchrist, P.C.*, 341 F. Supp. 2d 363, 381-82 (S.D.N.Y. 2004); *Asian Vegetable Research & Dev. Ctr. v. Inst. of Int'l Educ.*, 944 F. Supp. 1169, 1178-79 (S.D.N.Y. 1996) (validating disclaimer and further holding that where sophisticated "parties deal at arm's length in a commercial transaction, no relation of confidence or trust sufficient to find the existence of a fiduciary relationship will arise absent extraordinary circumstances").

785 Examiner's Interview of Christina Mohr, June 29, 2010; Examiner's Interview of Michael Costa, June 4, 2010.

786 *See* Report at § III.H.4.b.(1), III.H.4.b.(3), and III.H.4.b.(4).

787 Examiner's Interview of Christina Mohr, June 29, 2010; Examiner's Interview of Michael Costa, June 4, 2010.

788 Examiner's Sworn Interview of Rosanne Kurmaniak, July 7, 2010, at 56-57; 113-14; Ex. 972 (Persily E-Mail, dated June 11, 2007).

appears to have been primarily administrative,[789] although from time to time senior financial management did ask the individual at CGMI assisting on this task for her reactions to the reasonableness of certain assumptions underlying the projections.[790] This involvement might cause a court to conclude that CGMI was on inquiry notice regarding the reasonableness of Tribune's projections and hence possible insolvency. However, CGMI had no input (or apparent knowledge) regarding how VRC used management's projections to develop its solvency opinion and had no involvement in evaluating that opinion.

On balance, the Examiner concludes that it is reasonably likely that a court would find that MLPFS and CGMI acted in good faith, although the conclusion is more tenuous as to CGMI given its (albeit limited) participation in management's forecast. The Examiner recognizes, however, that if, in contrast to the Examiner's conclusions,[791] a court were to view the Citigroup Entities and the Merrill Entities respectively as essentially one entity for purposes of all good faith determinations, a court likely would reach a contrary conclusion and hold that any lack of good faith attributable to the Citigroup Entities or the Merrill Entities applies to all fees paid and obligations incurred collectively to those respective entities.

The Examiner acknowledges that his conclusions regarding the good faith of MLPFS and CGMI as Financial Advisors might seem at odds with his conclusions concerning JPMCB and MLCC as agents under their respective credit facilities and the JPM Entities, the Citigroup Entities, and the Merrill Entities as recipients of LBO Fees. The Examiner believes, however, that a court is reasonably likely to draw a distinction between the former and the latter because

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[789] Examiner's Sworn Interview of Rosanne Kurmaniak, July 7, 2010 at 60, 64; Ex. 971 (Kurmaniak E-Mail, dated Sept. 19, 2007).

[790] Examiner's Sworn Interview of Rosanne Kurmaniak, July 7, 2010 at 133:1-139:2; *see also* Ex. 889 (E-Mail exchange between Ms. Kurmaniak, Mr. Bigelow and others, dated September 27, 2007).

[791] *See* Report at §§ III.E.4.b. and III.E.4.c.

MLPFS and CGMI recused themselves from financial advisory services, and, therefore, those entities did not have any reason to evaluate VRC's opinion or the question of Tribune's Step Two solvency generally. By contrast, for the reasons discussed above, JPMCB and MLCC as agents stood in different positions and approached Step Two with different contractual rights. Although the Examiner acknowledges that a court may be less inclined to draw distinctions between the financial advisory arms of the Merrill and Citigroup Entities than the Examiner has,[792] for the reasons set forth in the Report, on balance the Examiner believes these distinctions are appropriate under the circumstances.

Because the Examiner has concluded that it is reasonably likely that a court would find that MLPFS and CGMI acted in good faith at the time of the close of both the Step One and Step Two Transactions, this means that if the Tribune Entities received reasonably equivalent value for the services rendered by MLPFS and CGMI, as discussed previously in the Report,[793] the Advisory Fees would not be avoidable or recoverable (and, to the extent the Tribune Entities received reasonably equivalent value, MLPFS and CGMI would be entitled to enforce their claims under Bankruptcy Code section 548(c)).

8. Legal Questions Concerning Remedies Available in Connection with Avoidance.

a. Examiner's Conclusions and Explanation Concerning the Questions of "Standing" and Scope of Avoidance at Guarantor Subsidiary Levels.

Examiner's Conclusions:

The Examiner concludes that it is highly likely that a court will find that each Guarantor Subsidiary that is a Debtor in the Chapter 11 Cases has standing to bring avoidance actions to

[792] *See id.* at §§ III.E.4.b., III.E.4.c., and III.H.4.c.(1).

[793] *See id.* at § IV.B.5.c(5).

avoid the obligations incurred to the LBO Lenders. To the extent a Guarantor Subsidiary unjustifiably fails to bring such action, a creditor or an official creditors' committee in such entity's case would be eligible to seek leave and obtain authority to bring such action on behalf of the estate. The Examiner concludes that a court is reasonably likely to find that if the estate representatives for Tribune *and* the Guarantor Subsidiaries were to successfully avoid the LBO Lender Debt, the value available from avoidance at the Guarantor Subsidiary estates would not be limited just to the satisfaction of the Non-LBO Debt at those levels.

Explanation of Examiner's Conclusions:

The Parties presented extensive argument on the question of whether Tribune's creditors would have "standing" to seek avoidance of the obligations incurred by the Guarantor Subsidiaries to the LBO Lenders, much of it keying off of the district court's decision in *Adelphia Recovery Trust v. Bank of America, N.A.*[794] *Adelphia* involved claims for fraudulent transfer that were asserted by a recovery trust created under a confirmed plan of reorganization. The trust sought to avoid and recover liens and obligations of certain Adelphia subsidiaries; the defendants argued that the trust could not bring claims because the creditors of the Adelphia subsidiaries that made the transfers were paid in full under the plan of reorganization.[795] Applying the principle that "a party does not have standing to sue where the party is not able to allege an injury that is likely to be addressed by the relief sought,"[796] the *Adelphia* court held that neither the former subsidiary's creditors nor the trust constituted an "injured party" for standing purposes. In the current case, there should be little question that Tribune's creditors are without standing to avoid fraudulent transfers of the Guarantor Subsidiaries. Absent substantive

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[794] *Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 80, 94 (S.D.N.Y. 2008), *aff'd*, 2010 WL 2094028 (2d Cir. May 26, 2010).

[795] *Id.* at 92.

[796] *Id.* at 95.

consolidation, alter ego, or piercing of the corporate veil of all the Guarantor Subsidiaries (none of which has been alleged, let alone shown here), Tribune's creditors have no such standing in the Guarantor Subsidiaries' cases.[797]

Ultimately, however, the question of standing to bring avoidance actions at the Guarantor Subsidiary levels is not substantial. As debtors in possession, the Guarantor Subsidiaries not only have the right but the exclusive standing to bring avoidance actions on behalf of their respective estates.[798] To the extent a Guarantor Subsidiary unjustifiably fails to commence such actions, any one of several candidates clearly having standing might seek leave to act as the representative of those estates. The UCC was appointed in each Chapter 11 Case and therefore is a party in interest in each case.[799] The Guarantor Subsidiaries also have their own Non-LBO Creditors. Finally, a creditor or creditor representative at Tribune might seek leave to be vested with authority to act as a representative of the Tribune estate with respect to its ownership interests in FinanceCo and Holdco for purposes of exercising Tribune's rights as stockholder of those entities, both to cause them and the Guarantor Subsidiaries to bring avoidance actions. In *Adelphia*, unlike here, because a plan of reorganization had been confirmed, none of these avenues was available.[800]

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[797] *See, e.g.*, *Magten Asset Mgmt. Corp v. Nw. Corp. Debenture Trust Co. (In re Nw. Corp.)*, 313 B.R. 595, 602 (Bankr. D. Del. 2004).

[798] *See, e.g.*, 11 U.S.C. §§ 323(a), 544(b)(1), and 548(a)(1) (2006).

[799] *See Notice of Appointment of Comm. of Unsecured Creditors* [Docket No. 101]; *see also* 11 U.S.C. § 1109 (2006); *Off. Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 580 (3d Cir. 2003) (en banc) ("[B]ankruptcy courts can authorize creditors' committees to sue derivatively to avoid fraudulent transfers for the benefit of the estate.").

[800] The bankruptcy court in *Adelphia* previously granted standing to the creditors' committee to pursue avoidance actions at the subsidiary level. It was only after the confirmed plan resulted in the payment in full of the subsidiary debtors' creditors and the release of the avoidance claims in question that the court found a lack of standing. *Adelphia Recovery Trust v. Bank of Am., N.A.*, 624 F. Supp. 2d 292, 332-33 (S.D.N.Y. 2009) (contrasting surviving fraudulent conveyance claim with those dismissed for lack of standing as not subject to a release).

Separate from the question of who might have standing to bring avoidance actions at the Guarantor Subsidiary levels is the more consequential question whether, if fraudulent transfer actions were successfully prosecuted at the Guarantor Subsidiary level, avoidance would inure to the benefit of Tribune's creditors who have no recourse to those entities under nonbankruptcy law. This result could occur if the LBO Lender Debt were avoided under Bankruptcy Code section 548, thereby effectively rendering the Guarantor Subsidiaries solvent and Tribune's interests in these entities highly valuable, after satisfaction of the Non-LBO Creditor liabilities. Avoidance of the LBO Lender Debt at Tribune in turn could allow Tribune's Non-LBO Creditors to receive payment in full from that newly-solvent estate.

It is important to appreciate that this question arises only in a scenario in which avoidance occurs at the Guarantor Subsidiaries' estates. Absent piercing of the corporate veil, alter ego, or substantive consolidation,[801] avoidance at Tribune but not the Guarantor Subsidiary estate would leave the lion's share of the value from those estates for the LBO Lenders whose claims would remain valid and enforceable at the Guarantor Subsidiary levels; that value would never be available to Tribune's creditors. This result follows from the provisions of the Subsidiary Guarantees which, among other things, specify that the obligation to pay "shall not be subject to any defense . . . , setoff, counterclaim, recoupment or termination whatsoever by reason of the invalidity, illegality or unenforceability of the Guaranteed Obligations or otherwise."[802] Under New York law (which the Guarantee Agreement selects as its governing

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[801] *See, e.g.*, *In re Owens Corning*, 419 F.3d 195, 215 n.27 (3d Cir. 2005) ("[S]ubstantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve . . . a "free pass" to spare Debtors or any other group from proving challenges, like fraudulent transfer claims, that are liberally brandished to scare yet are hard to show. If the Banks are so vulnerable to the fraudulent transfer challenges Debtors have teed up (but have not swung at for so long), then the game should be played to a finish in that arena. . . . If the bondholders have a valid claim, they need to prove it in the District Court and not use their allegations as a means to gerrymander consolidation of the estates.") (footnote omitted).

[802] *See* Report at §§ III.D.10.d. and III.G.3.d. Each Guarantor Subsidiary serves as "primary obligor and not merely as surety."

law),[803] the guarantees therefore are enforceable as independent obligations of the Guarantor Subsidiaries even if the underlying loan obligations are not enforceable for any reason, including the insolvency of the primary obligor.[804] This principle remains true and the guarantees remain enforceable even if Tribune Company's obligations under the Credit Agreement are avoided as fraudulent conveyances or otherwise.[805] Contrary to the contention of certain Parties, this conclusion is not tantamount to permitting parties to "opt out" of the fraudulent transfer law.[806]

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[803] In the Third Circuit, a forum selection clause will be enforced unless (1) the clause is a result of fraud or overreaching, (2) some strong local public policy would be violated if the clause is enforced, or (3) the opponent to the enforcement of such a clause would be forced to litigate in a jurisdiction that would be so seriously inconvenient to the opponent that it would be unreasonable. *Gen. Eng'g Corp. v. Martin Marietta Alumina*, 783 F.2d 352, 358 (3d Cir. 1986); RESTATEMENT (SECOND) OF CONFLICTS OF LAW, § 187 (1971). Thus, in *Citibank, N.A. v. Chammah*, 44 V.I. 85, 93 (V.I. Terr. Ct. 2001), the court applied New York law to enforce a provision of a guarantee that provided "the obligations of Guarantor hereunder are direct, unconditional and completely independent of the obligations of the Borrower."

[804] *See MF Global, Inc. v. Morgan Fuel & Heating Co.*, 896 N.Y.S.2d 326, 327 (N.Y. App. Div. 2010) ("The guaranties were unconditional and barred any defenses to the obligation they guarantied, so, although executed as part of the same transaction, they were intended to entail completely separate obligations.") (internal citations omitted); *Beal Bank, SSB v. Sandpiper Resort Corp.*, 674 N.Y.S.2d 83, 34 (N.Y. App. Div. 1998) ("[B]y the unqualified language contained in the guarantees, the guarantees are enforceable even if the principal escapes liability.") (citations omitted); *Raven Elevator Corp. v. Finkelstein*, 636 N.Y.S.2d 292, 293 (N.Y. App. Div. 1996) ("[L]iability of the guarantor may be broader than and exceed the scope of that of the principal where the guarantee, which is a separate undertaking, is, by its unqualified language, enforceable against the guarantor."); *Mfrs. Hanover Trust Co. v. Green*, 474 N.Y.S.2d 474, 475-76 (N.Y. App. Div. 1983) (holding that where guarantee states that it is enforceable even if underlying obligation invalid, irregular or unenforceable, guarantee is enforceable even if underlying obligation not enforceable against primary obligor); *see also Halper v. Halper*, 164 F.3d 830, 843 (3d Cir. 1999) (noting support for "proposition that unconditional guarantees that extend a guarantor's responsibility beyond that of the primary obligor are enforceable").

[805] *See Lowrey v. Mfrs. Hanover Leasing Corp. (In re Robinson Bros. Drilling)*, 6 F.3d 701, 704 (10th Cir. 1993) ("[C]ourts have recognized, without regard to any special guaranty language, that guarantors must make good on their guaranties following avoidance of payments previously made by their principal debtors."); *Feldman v. Chase Home Fin. (In re Image Masters, Inc.)*, 421 B.R. 164, 189 (Bankr. E.D. Pa. 2009) (citing *In re Coutee*, 984 F.2d 138, 141 (5th Cir. 1993), for the proposition that "avoidance of debtor's payment to bank on note did not extinguish a third party's guaranty of the note and the guarantor was liable to the bank on the guaranty"); *see also Moore, Owen, Thomas & Co. v. Coffey*, 992 F.2d 1439, 1449 (6th Cir. 1993) (finding that debtor's discharge did not affect guarantor's obligation to creditor); *In re Sandy Ridge Dev. Corp.*, 881 F.2d 1346, 1351 (5th Cir. 1989) (holding that discharge does not release non-debtor guarantors); *Centre Ins. Co. v. SNTL Corp. (In re SNTL Corp.)*, 380 B.R. 204, 213 (B.A.P. 9th Cir. 2007) ("[T]he return of a preferential payment by a creditor generally revives the liability of a guarantor."); *see also URSA Minor Ltd. v. AON Fin. Prod.*, 2000 U.S. Dist. LEXIS 10166, at *22-23 (S.D.N.Y. July 21, 2000) ("The Court finds that AFP has an obligation to pay irrespective of the Bond's potential invalidity or unenforceability with respect to GSIS . . . . [E]ven if GSIS could properly allege that the Bond was void ab initio, AFP's waiver would still apply.").

[806] *In re Pease*, 195 B.R. 431, 435 (Bankr. D. Neb. 1996) ("I conclude that any attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable.").

Rather, it recognizes that fraudulent transfer law has its limitations.[807] Moreover, contrary to the contention of another Party, general principles governing exoneration of a surety when the principal obligor is discharged have no bearing on the Subsidiary Guarantees, which remain enforceable absent avoidance.[808]

Nevertheless, it is possible to consider a scenario in which estate representatives for each and every Debtor successfully avoid the obligations incurred to the LBO Lenders in the Leveraged ESOP Transactions (in other words, all of the LBO Lender Debt); and those lenders manage to enforce only a portion of their obligations against each estate under the good faith defense asserted under Bankruptcy Code section 548(c) (or in the context of the Court's determination of reasonably equivalent value under section 548(a)(1)). To be clear, based on the Examiner's other findings in the Report, the Examiner does not believe that it is reasonably likely that a court would find that the Step One Transactions are avoidable as intentional or constructive fraudulent transfers. Because the Examiner recognizes that a court might disagree with these conclusions and the Parties have raised this issue, the Examiner considered whether, if all of the estates avoided the LBO Lender Debt, avoidance at the Guarantor Subsidiary levels would solely inure to the benefit of Non-LBO Creditors of the Guarantor Subsidiaries, with the remainder of the consideration going to satisfy the LBO Lender Debt.

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[807] To a great degree, principles of equitable subordination were developed to reach just results where the formalities of fraudulent transfer law would yield injustice. *See, e.g., Pepper v. Litton*, 308 U.S. 295 (1939).

[808] *Pro-Specialties, Inc. v. Thomas Funding Corp.*, 812 F.2d 797, 799 (2d Cir. 1987), does not compel a different conclusion. The court there held "on the facts before us, the district court could not have found a guarantee without first finding the principal debtor liable on the principal obligation." 812 F.2d at 799. The court then noted that, "[e]xcept in situations not applicable here, the general rule is that the guarantor is not liable unless the principal is bound." *Id.* For the reasons discussed above, this situation is not applicable here. Likewise, the court in *HSH Nordbank AG New York Branch v. Swerdlow*, 672 F. Supp. 2d 409, 418-19 (S.D.N.Y. 2009), actually enforced the guarantee there in the face of a contention that the underlying obligation had been discharged, noting that "advance consent provisions in a guaranty may render the guarantor liable even after a release of the principal borrower or modifications of the underlying loan." *See also R.I. Hosp. Trust Nat'l Bank v. Ohio Cas. Ins. Co.*, 789 F.2d 74, 78 (1st Cir. 1986) ("If, however, Ohio Casualty's suretyship was unconditional, it would be liable regardless of its principal's liability, unless it could raise an equitable defense.").

The Leveraged ESOP Transactions did not just involve Tribune or its assets alone; by design, the balance sheets of all of the Tribune Entities were changed. Tribune and the Guarantor Subsidiaries incurred the LBO Lender Debt at the same time—Tribune as borrower and the Guarantor Subsidiaries as guarantors and all of them as primary obligors—on the same underlying obligations to the LBO Lenders. The value that had been available to Tribune's creditors in the form of equity in the Guarantor Subsidiaries before the Leveraged ESOP Transactions was diluted by the Stock Pledge and the joint and several guarantees given by the Guarantor Subsidiaries in those transactions. In a scenario in which avoidance occurs by every estate as a constructive fraudulent transfer, by definition the court would find that all of those entities were rendered insolvent or left with unreasonably small capital at the same moment in time as a result of incurrence of the same underlying debt incurred in the same transactions. As the factors supporting collapse of the transactions within Step One and Step Two are no different for Tribune than the Guarantor Subsidiaries, the court would issue the same rulings concerning the appropriateness of collapse for all the Tribune Entities. In a scenario in which the LBO Lender Debt is found to be avoidable as to every debtor, would a court turn on a dime and allow the LBO Lenders—on account of their avoided obligations —to mop up all of the value left over after payment of the Guarantor Subsidiary creditors but before that value could find its way to Tribune's creditors?

The Examiner submits that to posit such a scenario is to answer the question posed. In the Examiner's view, it would be implausible for a court to find that avoidance is required as to each and every Debtor, only to reverse that avoidance for a moment in time to allow the LBO Lenders to recover the value from Guarantor Subsidiaries on account of their avoided obligations. Nothing in the language of Bankruptcy Code section 548 would support such a result. The statute provides for the avoidance of an obligation that is found constructively

fraudulent.[809] Avoidance renders that obligation unenforceable. [810] Avoidance under section 548 is distinguished from an action to recover property transferred or its value under Bankruptcy Code section 550(a), which, by its terms, only allows for recoveries "for the benefit of the estate."[811] No similar limitation is found in section 548 avoidance. Indeed, there is even authority under section 550 permitting recovery beyond that which is necessary to pay creditors in full.[812] It is true that the Third Circuit Court of Appeals endorsed the fundamental principal that "[t]he use of [the avoidance power] for the benefit of creditors is at the heart of the avoidance powers."[813] Of similar import is the Court of Appeal's statement that "the purpose of fraudulent conveyance law is to make available to creditors those assets of the debtor that are

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[809] 11 U.S.C. § 548(a)(1) (2006).

[810] *See Coleman v. Cmty. Trust Bank (In re Coleman)*, 426 F.3d. 719, 726 (4th Cir. 2005) ("Under the facts found by the bankruptcy court, the plain language of § 544 provides that Debtor 'may avoid' the deeds of trust . . . . The ruling of the bankruptcy court that the deeds of trust remain in effect as between Debtor and the Bank clearly infringes Debtor's right, unambiguously conferred by the Code, to nullify the grant of the deeds. We therefore hold that the bankruptcy court erred in limiting Debtor's ability to avoid the deeds of trust."); *Stalnaker v. DLC, Ltd. (In re DLC, Ltd.)*, 295 B.R. 593, 606 (B.A.P. 8th Cir. 2003) ("In enacting section 544(b), Congress expressly rejected limiting the estate's recovery to the amount of a particular creditor's claims."), *aff'd*, 376 F.3d 819 (8th Cir. 2004); *Glanz v. RJF Int'l. Corp. (In re Glanz)*, 205 B.R. 750, 757-58 (Bankr. D. Md. 1997) ("Section 548 imposes no requirement that an avoidance action be brought only under circumstances where the avoidance will result in a benefit to the bankruptcy estate.").

Although the court in *Coleman* viewed with suspicion the suggestion that the debtor in that case would benefit individually from avoidance, *Coleman*, 426 F.3d. at 726, the Fourth Circuit's construction of section 544 in that context is without ambiguity.

[811] 11 U.S.C. § 550(a) (2006). *MC Asset Recovery, LLC v. S. Co.*, 2006 U.S. Dist. LEXIS 97034, at *20 (N.D. Ga. Dec. 11, 2006) ("[A] trustee who brings an action to avoid and recover a fraudulent transfer may avoid and recover it in its entirety, even when the value of the transfer exceeds the value of all allowed claims of unsecured creditors"); *see also* 5 COLLIER ON BANKRUPTCY ¶ 548.01[1] (Alan A. Resnick & Henry J. Sommer eds., 16th ed.) ("[I]f the transaction is fraudulent within the rule set forth in section 548, the trustee may avoid it in its entirety."). *See also In re Coleman*, 426 F.3d at 726.

[812] *See Boyer v. Crown Stock Distrib., Inc.*, 587 F.3d 787, 797-98 (7th Cir. 2009); *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800, 811-12 (9th Cir. 1994); *In re Classic Drywall, Inc.*, 127 B.R. 874, 876 (D. Kan. 1991) ("[S]ection 550(a) . . . restore[s] the estate [as] if the transfer had not occurred."); *Glanz*, 205 B.R. at 758 ("Notwithstanding this fact, a debtor's power to avoid transfers pursuant to § 544(a) is not unrestricted, and equitable principles may be applied to bar a lien avoidance action where the avoidance does not accrue to the benefit of creditors but instead creates a windfall for the debtor.").

[813] *Off. Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery (In re Cybergenics Corp.),* 226 F.3d 237, 244 (3d Cir. 2000).

rightfully a part of the bankruptcy estate, even if they have been transferred away."[814] But these statements are truisms with which few courts could disagree. The Third Circuit Court of Appeals has not addressed directly the question whether avoidance under section 548 is subject to a limitation on the scope of avoidance or that any such limitation would support limiting the effect of avoidance in these circumstances. The Examiner concludes that the statutory language largely answers the question posed and does not support the limitation advocated by certain Parties.

Admittedly, some courts have imposed such a limitation, principally, but not exclusively, when the avoidance would inure to the benefit of an equity holder or would extend beyond the damages suffered by creditors.[815] But Tribune's ownership interest in the Guarantor Subsidiaries is several steps removed from the interests of Tribune's current equity holders in Tribune. Allowing the value derived from avoidance to flow from the Guarantor Subsidiaries to the Tribune estate (and then to Tribune's creditors) is not of the same tenor as allowing acquiring

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[814] *Buncher Co. v. Off. Comm. of Unsecured Creditors of GenFarm Ltd. P'ship. IV*, 229 F.3d 245, 250 (3d Cir. 2000). The court went on to state that "[w]hen recovery is sought under section 544(b) of the Bankruptcy Code, any recovery is for the benefit of all unsecured creditors, including those who individually had no right to avoid the transfer." 229 F.3d at 250. This latter statement is based on the plain language of section 544(b) codifying the Supreme Court's holding in *Moore v. Bay*, 284 U.S. 4 (1931).

[815] *See Balaber-Strauss v. Murphy (In re Murphy)*, 331 B.R. 107, 121 (Bankr. S.D.N.Y. 2005) (noting that avoidance under section 548 is limited to the extent necessary to satisfy allowed prepetition and administrative claims; *i.e.* those "*legally* harmed by a [transfer]"); *In re Crowthers McCall Pattern*, 120 B.R. 279, 288 (Bankr. S.D.N.Y. 1990) ("It is settled that even where the obligation is avoided, that avoidance would be only for the benefit of creditors and the obligation would still stand ahead of equity."). *Accord In re Newman*, 875 F.2d 668, 670-71 (8th Cir. 1989) (finding that no avoidance action may proceed with respect to the transfer of partnership property in the individual chapter 7 case of one of the partners); *Whiteford Plastics Co. v. Chase Nat'l Bank*, 179 F.2d 582, 584 (2d Cir. 1950); *Regency Holdings (Cayman), Inc. v. Microcap Fund, Inc. (In re Regency Holdings (Cayman), Inc.)*, 216 B.R. 371, 376 (S.D.N.Y. 1998).

One Party asserted that Bankruptcy Code section 502(h) embodies the "principle" that a creditor is entitled to enforce an obligation as against the estate, citing, *e.g.*, *Fleet Nat'l Bank v. Gray (In re Bankvest Capital Corp.)*, 375 F.3d 51, 62 (1st Cir. 2004) ("[W]hen grounds for avoidance are found, however, a creditor . . . becomes entitled to pursue whatever claim it may have had in the avoided sum against the debtor") and *In re Bd. of Dirs. of Hopewell Int'l Ins. Ltd.*, 238 B.R. 25, 55 (Bankr. S.D.N.Y. 1999) ("So strong is [the principle that avoidance powers can only be exercised for the benefit of creditors] that a transfer, avoidable as fraudulent by a creditor, is considered valid as between a grantor and grantee"). As discussed in another part of the Report, *see* Report at § IV.B.8.b., however, section 502(h) has no application to avoidance of obligations, and an obligee's right to enforce an obligation is governed exclusively by Bankruptcy Code section 548(c).

stockholders in a leveraged buyout transaction to benefit from avoidance of the very debt they procured to make the transaction possible. Although it is true that Tribune's creditors did not bargain as a matter of nonbankruptcy law for recourse to the Guarantor Subsidiaries, it is hard to fathom that a court would permit the lenders whose debt would be avoided to enforce their structural seniority in this avoidance scenario. The so-called "participant bar" cases—arguably standing for the proposition that a trustee cannot assert an avoidance action when recovery would only benefit creditors or other parties who *expressly consented* to or participated in the transaction in question[816]—have little to do with the circumstance presented here. In the posited scenario, the fact that the Leveraged ESOP Transactions involved all of the Tribune Entities and rendered them all insolvent or unreasonably capitalized at the same time would have consequences. The Examiner finds it reasonably unlikely that a court would allow the LBO Lenders to recover ahead of Tribune's creditors from the Guarantor Subsidiaries in the posited scenario.

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[816] In *Morin v. OYO Instruments, L.P. (In re Labelon Corp.)*, 2006 Bankr. LEXIS 2490, at *10 (Bankr. W.D.N.Y. Aug. 28, 2006), the court stated that "on equitable grounds, this Court would not make a finding of avoidance and recovery, when the only entity that would benefit from that avoidance and recovery would be, [one] which specifically approved the . . . transaction in writing and benefited from the transaction . . . .". This statement was dictim at best, however, as the court also denied leave to amend the complaint in question (an inherently discretionary question) because the amendment would not relate back to the original complaint. *Id*. In *Harris v. Huff (In re Huff)*, 160 B.R. 256, 261 (Bankr. M.D. Ga. 1993), the court applied long-standing jurisprudence under Bankruptcy Code section 544(b):

> The general rule is that section 544(b) confers upon the trustee no greater rights of avoidance than the creditor himself would have if he were asserting invalidity on his own behalf. Consequently, if the creditor is deemed estopped to recover upon his claim, or is barred from recovery because of the running of a statute of limitations prior to the commencement of the case, the trustee is likewise rendered impotent."

The court observed also (not controversially) that: "A transaction that is voidable by a single, actual unsecured creditor may be avoided in its entirety, regardless of the size of the creditor's claim." *Id.*

b. Examiner's Conclusions and Explanation Concerning Participation of Creditors Whose Claims, Payments, or Liens are Avoided in Creditor Distributions.

Examiner's Conclusions:

To the extent a transferee of an avoided transfer pays the amount avoided or turns over such property, the transferee will be entitled to assert a claim against the estate to which the funds are paid or returned equal to the non-constructively fraudulent claim. To the extent, however, an obligee's claim is avoided, a court is reasonably likely only to permit participation of such a claim, if at all, in distributions from the estate to the extent the claim is supported by reasonably equivalent value or Non-LBO Creditor claims are paid in full plus postpetition interest. It is reasonably likely that if Step Two Debt, but not Step One Debt, is avoided, absent an otherwise applicable basis to subordinate or disallow the Step One Debt or assert rights of unjust enrichment, the Step One Debt would participate in distributions from the estates in accordance with applicable nonbankruptcy priorities, although a question exists whether the Step One Debt would participate in any recoveries of payments made in connection with avoidance of the Step Two Transactions.

Explanation of Examiner's Conclusions:

Bankruptcy Code section 502(d)[817] provides that a transferee may not participate as a creditor unless and until such transferee pays the amount of or returns the avoidable transfer to the estate.[818] Case law teaches that, on satisfaction of this precondition, a transferee of an avoided transfer "should be allowed to prove whatever claim it would have had in the absence of

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[817] 11 U.S.C. § 502(d) (2006).

[818] *Scharffenberger v. United Creditors Alliance Corp. (In re Allegheny Health, Educ. & Research Found.)*, 292 B.R. 68, 74 (Bankr. W.D. Pa. 2003), *aff'd sub nom., Risk Mgmt. Alts., Inc. v. Scharffenberger (In re Allegheny Health Educ. & Research Found.)*, 127 F. App'x 27 (3d Cir. 2005). Similarly, by its terms, this provision does not allow a claim in favor of the holder of an avoided transfer but conditions any participation in distributions from the estate on such payment or return. *See* 11 U.S.C. § 502(h) (2006).

its fraudulent behavior."[819] Applied here, to the extent the transferee of an avoidable transfer restores the estate on account of the constructively fraudulent transfer, the transferee may assert an allowed claim equal to the non-constructively fraudulent portion of its claim.[820]

Section 502(d) applies only to the avoidance of transfers, not obligations.[821] An obligee's entitlement to enforce its claim against the estate is governed exclusively by Bankruptcy Code section 548(c).[822] To the extent a claim cannot be enforced under section 548(c), there is no basis under any other applicable Bankruptcy Code provision to enforce that claim against the bankruptcy estate.[823] It would be nonsensical, moreover, to apply section 548(c)—with the object of fixing the portion of the claim that may be enforced and the portion that may not—only to turn around and allow the constructively fraudulent portion of the avoided claim. Nevertheless, the bankruptcy court in *Best Products* suggested in dictum that there may be room to afford a lender that acted in good faith in a leveraged buyout transaction the right to participate in bankruptcy dividends beyond the amount of the obligation conferring reasonably equivalent value: "There is respectable commentary to the effect that LBO lenders should have a

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819 *Misty Mgmt. Corp. v. Lockwood*, 539 F.2d 1205, 1214 (9th Cir. 1976) ("[A] transferee guilty of fraudulent behavior may nevertheless prove a claim against the bankrupt estate, once he returns the fraudulently conveyed property to the estate. A rule to the contrary would allow the estate to recover the voidable conveyance and to retain whatever consideration it had paid therefor. Such a result would clearly be inequitable.") (internal citations omitted); *accord Verco Indus. v. Spartan Plastics (In re Verco Indus.)*, 704 F.2d 1134, 1139 (9th Cir. 1983).

820 *See In re Hough*, 4 B.R. 217, 219 (Bankr. S.D. Cal. 1980) ("Thus, that Court held that the transferee should be allowed to prove whatever claim it would have had in the absence of its fraudulent behavior. [T]his Court has concluded that Claimant gave no consideration for the transfer by the bankrupt of the Full Moon liquor license to her. Therefore, she has no claim against the estate.").

821 *In re Asia Global Crossing, Ltd.*, 333 B.R. 199, 202 (Bankr. S.D.N.Y. 2005). Likewise, section 502(h) is inapposite.

822 11 U.S.C. § 548(c) (2006).

823 *See Murphy v. Meritor Savs. Bank (In re O'Day Corp.)*, 126 B.R. 370, 411 (Bankr. D. Mass. 1991) ("In fact, Meritor contends that, should the Court sustain the Trustee's fraudulent conveyance action, it would remain as an unsecured creditor. Consequently, the Bank takes the position that, as a creditor of the estate with a proof of claim on file, it is entitled to its *pro rata* distribution of the estate's assets unless an objection to Meritor's proof of claim is filed and sustained by the Court or, alternatively, its claim is equitably subordinated under section 510 of the Bankruptcy Code. The Court disagrees. The language of the UFCA and the Bankruptcy Code supports the position taken by the Trustee.").

claim for all the consideration with which they have parted. Invalidation seems particularly draconian in a legitimate LBO because the creditors actually parted with value."[824] The court went on, however, to suggest that a contrary result might well be appropriate even as a matter of equity jurisprudence—and that the most one could conclude from the case law was that a lender holds an unsecured claim to the extent it gave reasonably equivalent value: [825]

> On the other hand, if the underlying fraudulent transfer statute (such as DCL § 273) provides for the avoidance as fraudulent of an obligation incurred, it could be argued fairly persuasively that so much of the obligation which the debtor incurred as was not supported by consideration *to the debtor,* ought be avoidable. *Cf. McColley v. Rosenberg (In re Candor Diamond Corp.)*, 76 B.R. 342 (Bankr. S.D.N.Y. 1987) (under section 548 of the Bankruptcy Code, where consideration for transfers which left debtor insolvent was paid to debtor's principal and his family, rather than to the debtor, the debtor's transfers were made for less than a reasonably equivalent value and were avoidable); *accord* 1 *Glenn* § 286 at 481.

The relatively few other courts to actually confront the question of the treatment of the constructively fraudulent portion of a creditor's claim have suggested that equitable subordination of the claim of the obligee on an avoided transfer to other creditor claims might be an appropriate remedy as a means of enabling innocent creditors to be made whole from the constructively fraudulent transfer.[826]

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[824] *RTC v. Best Prods. Co. (In re Best Prods. Co.)*, 168 B.R. 35, 59 (Bankr. S.D.N.Y. 1994) (citation omitted), *aff'd on other grounds*, 68 F.3d 26 (2d Cir. 1995). Thus, the court noted: "But this much is unassailable: to the extent that the lenders gave consideration to the debtor, such as here, in the form of working capital which the Banks gave to Best at the time of the merger, the lenders would have a claim which would be allowable so long as they satisfied the judgment arising out of the fraudulent transfer action." *Id.* at 58 (footnote omitted).

[825] *Id.*

[826] *See West v. Hsu (In re Advanced Modular Power Sys.)*, 413 B.R. 643, 677 (Bankr. S.D. Tex. 2009) (concluding that a trustee could both avoid transfers to insiders and subordinate their resulting claims; "In sum, because all three prongs of the Fifth Circuit's [*Mobile Steel*] test are met, this Court will not allow the Defendants to benefit from their inequitable conduct at the expense of AMPS's creditors. Therefore, any claims the Defendants may have for monies recovered by the Trustee are subordinate to both the Trustee's claims and any other creditor's claim against the estate."); *Pajaro Dunes Rental Agency v. Spitters (In re Pajaro Dunes Rental Agency)*, 174 B.R. 557, 598 (Bankr. N.D. Cal. 1994); *In re Crowthers McCall Pattern, Inc.*, 120 B.R. 279, 288 (Bankr. S.D.N.Y. 1990). *But see generally Boyer v. Crown Stock Distrib., Inc.*, 587 F.3d 787, 797 (7th Cir. 2009) ("But as far as we can tell, should all the unsecured creditors of new Crown be paid in full the only other potential claimants to any surplus money in its estate will be the original shareholders. The LBO was fraudulent only

The preceding discussion addresses what happens when a claim is avoided. Additional issues arise when a creditor holds one claim that is avoided and another claim that is not. A straightforward application of the relevant Bankruptcy Code provisions makes it abundantly clear that barring equitable subordination, disallowance, or principles of unjust enrichment, if the Step Two Debt but not the Step One Debt is unavoidable, the Step One Debt would be entitled to participate in distributions from the estates in accordance with their nonbankruptcy priorities. Contrary to the contention advanced by one Party to the Examiner, Bankruptcy Code sections 502(d) and (h) provide no basis to disallow Step One Debt based on avoidance of Step Two Debt. As noted, these Bankruptcy Code provisions do not apply to avoidance of claims.

An argument nevertheless may be advanced that a court should prohibit the holders of the Step One Debt from participating in any *recoveries* of payments made in connection with *avoidance* of the Step Two Transactions until the Non-LBO Creditors holding claims against the particular Debtor-entities are paid in full. These are the same creditors (or their successors) who indeed participated in, funded, and made possible the Step Two Transactions. Thus, so the argument goes, it would be inequitable for those entities to benefit from avoidance of payments made and obligations incurred in the Step Two Transactions while non-LBO Creditors holding claims against the same estates remain unpaid. Although this argument may be appealing as an equitable matter, it is generally understood that an estate representative may bring actions to avoid and recover transfers for the benefit of creditors who might not have any right to bring those actions on their own accord.[827] Absent a basis to equitably subordinate the Step One Debt

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with respect to the unsecured creditors. If and when they are paid in full, the wrong committed by the shareholders will have been righted and there will be no reason to deny their claims to whatever money is left over.").

[827] *See Buncher Co. v. Off. Comm. of Unsecured Creditors of GenFarm Ltd. P'shp IV*, 229 F.3d 245, 250-51 (3d Cir. 2000) (applying Bankruptcy Code section 544(b); "When recovery is sought under section 544(b) of the

consistent with the standards governing equitable subordination discussed later in the Report,[828] it is difficult to find a doctrinal basis that would support barring that debt from participating in avoidance recoveries.[829]

The doctrine of equitable estoppel, however, may furnish such a basis, even if the standards governing equitable subordination are not otherwise met.[830] As one bankruptcy court noted: "[S]ince this Court inherently possesses the powers of equity, it may employ the equitable estoppel doctrine in a manner not inconsistent with the Code."[831] But, equitable estoppel is at best an imperfect fit, as that doctrine typically requires some form of representation from the party against whom estoppel is sought in favor of the party seeking estoppel, with some

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Bankruptcy Code, any recovery is for the benefit of all unsecured creditors, including those who individually had no right to avoid the transfer.").

828 *See* Report at § IV.D.1. Although equitable subordination is not a static concept, affording courts flexibility to fashion remedies as new fact patterns emerge, *see United States v. Noland*, 517 U.S. 535, 540 (1996) ("[T]he adoption in § 510(c) of 'principles of equitable subordination' permits a court to make exceptions to a general rule when justified by particular facts, *cf. Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944) ("The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case."), the Examiner has not found any equitable subordination case that would support the result discussed in the Report. Moreover, "[e]quitable subordination is remedial not penal." *In re Mid-Am. Waste Sys.*, 284 B.R. 53, 72 (Bankr. D. Del. 2002). *See also In re Ahlswede,* 516 F.2d 784, 788 (9th Cir. 1975) ("A supposed inequity resulting when an innocent party in good faith asserts a legally valid claim will not [support disallowance or subordination of a claim].") (citation omitted); *In re Columbia Ribbon Co.*, 117 F.2d 999, 1002 (3d Cir. 1941) ("It does not hold that the court may set up a sub-classification of claims within a class given equal priority by the Bankruptcy Act and fix an order of priority for the sub-classes according to its theory of equity.").

829 In *In re PWS Holding Corp.*, 228 F.3d 224, 240 (3d Cir. 2000), the Third Circuit Court of Appeals referenced an examiner's report issued in that case (under seal) in which the examiner opinioned that "there was some likelihood that the Banks and the subordinated noteholders, as participants in the leveraged recapitalization, would be estopped from recovering on the claims." The Third Circuit, however, did not expressly endorse the examiner's opinions.

830 *See IRS v. Kaplan (In re Kaplan),* 104 F.3d 589, 601 at n.27 (3d Cir. 1997) ("The traditional elements of equitable estoppel are: '(1) the party to be estopped must have known the facts; (2) the party to be estopped must intend that his conduct will be acted upon or must so act that the party asserting the estoppel has the right to believe it was so intended; (3) the party asserting estoppel must be ignorant of the true facts; and (4) the party asserting estoppel must rely on the other party's conduct to his injury.'") (citing *In re Jones,* 181 B.R. 538, 543 (D. Kan. 1995); *Penny v. Giuffrida,* 897 F.2d 1543, 1545-46 (10th Cir. 1990)).

831 *In re Lafayette Radio Elecs. Corp.*, 7 B.R. 189, 193 (Bankr. E.D.N.Y. 1980) (citing *Pepper v. Litton*, 308 U.S. 295, (1939)); *see also Frymire v. PaineWebber, Inc.*, 107 B.R. 506, 511 (E.D. Pa. 1989) (stating that equitable estoppel "is a defense used to preclude a person from denying or asserting a claim") (citation and internal quotation marks omitted).

courts requiring a false representation.[832] In the current case, the LBO Lenders did not make any representations to the Non-LBO Creditors.[833]

Because the law is not clear, the Examiner leaves this question in equipoise. The Recovery Scenarios contained in Annex B to this Volume of the Report, however, illustrate in one scenario (Case 8) the results if a court were to prohibit the Step One Debt from sharing in recoveries from avoidance of the Step Two Debt.[834] (That scenario also posits that the LBO Lenders are not entitled to enforce any portion of the Step Two Debt.)

c. Examiner's Conclusions and Explanation Concerning Effect of Avoidance on PHONES Subordination.

Examiner's Conclusions:

To the extent the LBO Lender Debt is not avoided (or if avoided, to the extent enforced under Bankruptcy Code section 548(c)), the LBO Lenders will be entitled to recover value at the Guarantor Subsidiary level and enforce their rights under the PHONES Subordination at the Tribune level with respect to distributions from the Tribune estate. Although not entirely clear, the Examiner concludes that a court is reasonably likely to hold that the PHONES Subordination would not extend to LBO Lender Debt that is avoided at the Tribune level.

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832 *See In re Rowland*, 275 B.R. 209, 217 (Bankr. E.D. Pa. 2002) (finding equitable estoppel requires "a representation of material fact was made to the party") (citation omitted); *In re Grigoli*, 151 B.R. 314, 321 (Bankr. E.D.N.Y. 1993) ("Equitable estoppel may be invoked only if the following elements are present: (1) conduct which amounts to a false representation, (2) reliance on the conduct of the party to be estopped, and (3) a detrimental change of position based on the conduct.").

833 The doctrine of ratification may provide an alternative source. *See generally HSBC Bank USA, N.A. v. Adelphia Commc'ns Corp.,* 2009 U.S. Dist. LEXIS 10675, at *18 (W.D.N.Y. Feb. 12, 2009); 1 GERRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES, §§ 111, 113 (rev. ed. 1940) ("'Ratification results when a party to a voidable contract accepts benefits flowing from the contract, or remains silent, or acquiesces in contract for any considerable length of time after he has had opportunity to annul or void the contract."). The Examiner, however, has not found cases applying this doctrine in the context considered here.

834 Arguments similar to the ones discussed in text can be advanced regarding any participation by the holders of the EGI-TRB Notes in any recoveries from avoidance actions. The Examiner likewise leaves this question in equipoise.

Explanation of Examiner's Conclusions:

Bankruptcy Code section 510(a) provides that "[a] subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable non-bankruptcy law."[835] To the extent the LBO Lender Debt is not avoided (or if avoided, to the extent enforced under Bankruptcy Code section 548(c)), the LBO Lenders will be entitled to recover value at the Guarantor Subsidiary level and enforce their rights under the PHONES Subordination at the Tribune level regarding distributions from the Tribune estate. By its terms, Bankruptcy Code section 548(c) permits enforcement of a claim to the extent the prerequisites of that section are satisfied. The PHONES Subordination would apply at the Tribune level to the extent the LBO Lender Debt remains valid against Tribune or a particular Guarantor Subsidiary estate.

The more difficult question is whether, to the extent the LBO Lender Debt is avoided at the Tribune level, the PHONES Subordination continues with respect to the avoided portions of the LBO Lender Debt. In other words, could the LBO Lenders turn around and recover on their avoided claims any distributions from the estate on the PHONES Notes?[836] No case law has been found answering this specific question in an analogous setting. The closest is *In re Best Products Co.*,[837] discussed previously, in which certain parties objected to a settlement that resolved and allowed the claim of a fraudulent transfer target; the bankruptcy court's approval of the settlement meant that the lender's claim was senior to the claim of the subordinated creditor

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[835] 11 U.S.C. § 510(a) (2006); *see also In re Hinderliter Indus.*, 228 B.R. 848, 853 (Bankr. E.D. Tex. 1999) ("[J]unior creditors should be prevented from receiving funds where they have 'explicitly' agreed not to accept them.") (internal citations omitted); *Citibank, N.A. v. Smith Jones*, 17 B.R. 128, 131 (Bankr. D. Minn. 1982) (holding subordination agreement enforced postpetition in favor of holder of bank debt).

[836] The Examiner is required to address this question because it was raised by Parties, and the answer affects the Recovery Scenarios set forth in Annex B to Volume Two.

[837] 168 B.R. 35, 39 (Bankr. S.D.N.Y. 1994), *aff'd on other grounds*, 68 F.3d 26 (2d Cir. 1995).

under the party's subordination agreement. Faced with an objection to enforcement of the subordination provision, the court noted that even if the settlement had not been approved, the lender still would have held a substantial senior unsecured claim that would have survived avoidance.[838] Although the court intimated that, under the subordination provisions at issue, the lender's claims would be senior notwithstanding avoidance (noting that the subordinated creditor had presented no case for equitable subornation), it is not clear from the opinion what the subordination provision actually said. Moreover, because the specific question presented was whether the lender's allowed claim under the settlement constituted senior indebtedness, and not whether the lender would hold a senior claim if its claims were entirely avoided, at most the court's comments concerning the operation of the subordination agreement were dicta.

It is well established that avoidance of an obligation does not empower the trustee to step into the shoes of that creditor's seniority rights under a contractual subordination.[839] Moreover, notwithstanding avoidance of an obligation, "[t]he subordination agreement, which provided underpinning for the Bank's loan, should be enforced in the distribution of the proceeds of the trustee's sale according to the terms of the parties who made the agreement."[840] Applying this principle, a court might conclude that avoidance of the LBO Lender Debt at the Tribune level simply has no bearing on the operation of the PHONES Subordination and that, accordingly, the LBO Lenders may continue to enforce that subordination notwithstanding the avoidance of the LBO Lender Debt by the Tribune estate. The problem with this conclusion, however, is that it

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838 *Id.* at 70.

839 *See Morris v. St. John Nat'l Bank (In re Haberman)*, 516 F.3d 1207, 1211-12 (10th Cir. 2008); *In re Kors, Inc.*, 819 F.2d 19, 23-24 (2d Cir. 1987) ("At the same time, the Bank's rights with respect to its unperfected security interest on Kors' collateral were separate and distinct from its rights under the subordination agreement among the lenders. Therefore, the trustee, acting under §§ 544(a)(1) and 551 obtained only those rights and powers derived from the unperfected security interest against Kors in the collateral and did not acquire the rights of the Bank under the subordination agreement. Consequently, the bankruptcy court should have enforced the subordination agreement according to the terms of the parties to that agreement.") (citation omitted).

840 *In re Kors, Inc.*, 64 B.R. 163, 170 (D. Vt. 1986), *aff'd*, 819 F.2d 19 (2d Cir. 1987).

assumes that the PHONES Subordination extends to the LBO Lender Debt even if that indebtedness is avoided, and does not consider what the PHONES Indenture actually says.

Subordination agreements are enforceable in bankruptcy only to the extent they are enforceable under "applicable nonbankruptcy law."[841] Because the PHONES Indenture is governed by New York law, a court is likely to apply New York principles of contract interpretation to interpret the PHONES Indenture. The definitions of "Indebtedness" and "Senior Indebtedness" in the PHONES Indenture do not by their terms expressly subordinate the PHONES Notes to debt that is avoided in a Tribune bankruptcy. In fact, the PHONES Indenture's only reference to bankruptcy in the definition of Senior Indebtedness is the statement that postpetition interest is only included as Senior Indebtedness if and to the extent allowed by a bankruptcy court.[842] Although the Examiner has found no authority directly addressing this question, the Examiner concludes that, based on the New York Court of Appeals decision on certification in *Chemical Bank v. First Trust (In re Southeast Banking Corp.)*,[843] a New York court likely would require specific language in the PHONES Subordination to alert the holders that Senior Indebtedness includes debt that is avoided in a bankruptcy proceeding.[844] That explicit language is missing from the PHONES Indenture, and, as a result, a court is reasonably likely to conclude that the PHONES Subordination does not extend to avoided debt. This

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841 11 U.S.C. § 510(a) (2006).

842 Ex. 49 at § 14.01 (PHONES Indenture).

843 710 N.E.2d 1083 (1999).

844 *Id.* at 1087; *see also In re King Res. Co.*, 528 F.2d 789, 791 (10th Cir. 1976); *In re Bank of New Eng. Corp.*, 404 B.R. 17, 39 (Bankr. D. Mass. 2009), *aff'd sub nom. HSBC Bank USA v. Bank of N.Y. Trust Co. (In re Bank of New Eng. Corp.)*, 426 B.R. 1 (D. Mass. 2010). *But see HSBC Bank USA v. Branch (In re Bank of New Eng. Corp.)*, 364 F.3d 355, 365-67 (1st Cir. 2004) (disagreeing with the holding of *Chemical Bank v. First Trust (In re Southwest Banking Corp.)*, 710 N.E.2d 1083, 1084-88 (N.Y. 1999), and instead holding that New York law does not require specific language in a subordination agreement to alert the holders of subordinated debt that senior creditors will receive postpetition interest in a bankruptcy case before the holders of the junior debt receive principal).

construction is consistent with controlling precedent from the Third Circuit Court of Appeals applying the "Rule of Explicitness,"[845] which presents an analogous issue.

d. Examiner's Conclusions and Explanation Concerning Effect of Avoidance on Subordinated Bridge Subsidiary Guarantee.

Examiner's Conclusions:

To the extent the Credit Agreement Debt and Bridge Debt are not avoided (or if avoided, to the extent enforced under Bankruptcy Code section 548(c)) at the Guarantor Subsidiary levels, the subordination provisions of the Subordinated Bridge Subsidiary Guarantee will remain in effect and govern distributions from the Guarantor Subsidiary estates. It is reasonably likely that to the extent those obligations are avoided and are not enforced under section 548(c) at the Guarantor Subsidiary levels and the Stock Pledge is avoided, such avoidance would avoid, and thereby render inoperative the subordination provisions of the Subordinated Bridge Subsidiary Guarantee, such that any value distributed by Tribune (including amounts available to Tribune as a result of the remittance of value from the Guarantor Subsidiaries to Tribune resulting from avoidance of the LBO Lender Debt) would be ratably distributed between the Credit Agreement Debt and the Bridge Debt. However, in connection with fashioning remedies resulting from avoidance, a court is reasonably likely to adjust this result if Non-LBO Creditors are made whole.

Explanation of Examiner's Conclusions:

There would be no basis to relieve the Bridge Facility Lenders of the subordination provisions contained in the Subordinated Bridge Subsidiary Guarantee to the extent the Credit

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[845] *In re Time Sales Fin. Corp.*, 491 F.2d 841, 844 (3d Cir. 1974). Although additional potential bases were presented to the Examiner going to the question whether the PHONES Subordination remains enforceable based on actions by the LBO Lenders allegedly not taken in good faith (*see generally* PHONES Indenture § 14.09), these contentions are outside the purview of the Investigation because they involve inter-creditor contentions and claims and not estate actions.

Agreement Debt remains valid at the Guarantor Subsidiary levels.[846] To the extent the Credit Agreement Debt and the Bridge Debt are avoided by the Guarantor Subsidiary estates, however, a more complex question arises concerning the effect of such avoidance on the subordination provisions of the Subordinated Bridge Subsidiary Guarantee. Had the Credit Agreement Agent and the Bridge Credit Agreement Agent entered into a contractual subordination agreement dealing with this question and specifying that, as between the Credit Agreement Debt and the Bridge Debt, the subordination provisions would survive avoidance and govern the distribution of any value derived from the Guarantor Subsidiaries, such a contract undeniably would be enforced,[847] but the Subordinated Bridge Subsidiary Guarantee entered into between each Guarantor Subsidiary and the Bridge Credit Agreement solely governs the scope of that subordination. No contractual subordination agreement exists between the Bridge Credit Agreement Agent and the Credit Agreement Agents, and, in fact, the Bridge Debt and Credit Agreement Debt are pari passu at Tribune (although the Credit Agreement Debt is secured by the Stock Pledge). Although the Subordinated Guarantee provides that its terms survive nullification of Tribune's obligations, nothing in the Subordinated Bridge Subsidiary Guarantee could bulletproof those guarantees against avoidance by a Guarantor Subsidiary's bankruptcy estate. As a result, if the LBO Lender Debt is avoided by a Guarantor Subsidiary—such that the Credit Agreement Subsidiary Guarantee and the Subordinated Bridge Subsidiary Guarantee are no longer enforceable against that entity and no distributions from that estate on account of those guarantees will occur—the subordination contained in the Subordinated Bridge Subsidiary

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[846] *See In re Best Prods.*, 168 B.R. 35, 70 (Bankr. S.D.N.Y. 1994) ("[I]n the event the LBO were to be deemed fraudulent, the Banks would be left with a substantial claim . . . . Thus, . . . a debt would still be due and owing to the Banks under the most favorable litigation scenario from [the debtor]'s viewpoint, as a result of which the claims of the [junior creditors] would be [and remain] subordinated to those of the Banks.").

[847] *See* Report at § IV.B.8.c.

Guarantee likewise should fall away.[848] Stated differently, if the obligations of the Guarantor Subsidiaries under both of these guarantees are avoided, there would be nothing to which the subordination contained in the Subordinated Bridge Subsidiary Guarantee could extend.

The Examiner concludes, however, that notwithstanding the preceding discussion, in connection with fashioning remedies resulting from avoidance at the Guarantor Subsidiary levels when Non-LBO Creditors are made whole, a court is reasonably likely to adjust the distributions so that the relative pre-avoidance priorities between the Credit Agreement Debt and Bridge Debt are honored regarding that portion of the value available that is attributable to the Guarantor Subsidiaries. It would seem inequitable to allow the holders of the Bridge Debt to, in effect, benefit from avoidance of their own debt at the Guarantor Subsidiaries; thus, as between the Credit Agreement Debt and Bridge Debt, a court should enforce the prepetition arrangements to which those holders agreed once all *other* creditors are paid in full plus interest. The Examiner recognizes, however, that no case law addresses this question.

e. Examiner's Conclusions and Explanation Concerning Treatment of Intercompany Claims in Avoidance Scenarios.

The Examiner has reviewed the Parties' submissions regarding intercompany claims existing as of the Petition Date. Based on this review, the Examiner has determined that no Party has challenged the analysis prepared by the Debtors regarding the likely percentage range of

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[848] *See generally Grace v. Bank Leumi Trust Co.*, 443 F.3d 180, 189 (2d Cir. 2006) ("The proper remedy in a fraudulent conveyance claim is to rescind, or set aside, the allegedly fraudulent transfer, and cause the transferee to return the transferred property to the transferor."). It is important to point out, however, that avoidance and rescission are not synonymous. *See, e.g., United States ex rel. FCC v. GWI PCS 1, Inc. (In re GWI PCS 1, Inc.),* 230 F.3d 788, 796 n. 14 (5th Cir. 2000) ("Avoidance differs considerably from rescission. Rescission unwinds the transaction and restores the status quo ante, whereas avoidance allows a debtor to retain the benefit of its bargain while rewriting the debtor's obligations under that bargain."). *See also FCC v. NextWave Commc'ns (In re NextWave Pers. Commc'ns, Inc.),* 200 F.3d 43, 49 n.6 (2d Cir. 2000). Bankruptcy Code section 548(c) provides the sole statutory basis for an obligee to enforce an obligation that otherwise would be avoided. 11 U.S.C. § 548(c) (2006). *See* Report at §§ IV.B.5.b., IV.B.5.c. In this fashion, section 548(c) affords an obligee or transferee to rescind the effect of avoidance subject to compliance with the limitations imposed under that section.

intercompany claims that would be allowed for purposes of determining recoveries to creditors in various avoidance scenarios.[849] Because Question One is limited to claims and defenses asserted by the Parties, the Examiner has not independently analyzed the validity of such claims, which represent hundreds of thousands of individual transactions over the Debtors' history.[850] The Examiner uses the Debtors' analysis of intercompany claims supplied to the Examiner in the analysis of Recovery Scenarios contained in Annex B to this Volume of the Report.

9. Examiner's Conclusions and Explanation Concerning the Economic Effect of Potential Avoidance on Distributions.

With the assistance of his financial advisor, the Examiner has prepared the Recovery Scenarios in Annex B to this Volume of the Report. Readers are directed to the notes accompanying that analysis for the underlying assumptions.

C. Potential Preference Actions.

Certain Parties contended that one or more of the Tribune Entities may recover as preferential transfers payments and other transfers made in connection with and following the Leveraged ESOP Transactions. The potential preferential transfers identified by the Parties include (i) satisfaction of the Exchangeable EGI-TRB Note, (ii) payments made to the LBO Lenders within the ninety-day period before the Petition Date, (iii) payments made to directors and officers of the Tribune Entities within one year before the Petition Date, and (iv) transfers between and among Tribune and its subsidiaries within one year before the Petition Date.

The Parties devoted little analysis to these issues. Indeed, no Party attempted to demonstrate that each of the substantive elements necessary to recover a preferential transfer

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[849] *See* Ex. 1071 (Debtors' Assumptions re Intercompany Claims); Ex. 1072 (Debtors' Analysis of Recovery Scenarios).

[850] *See* Ex. 1071 (Debtors' Assumptions re Intercompany Claims).

could be satisfied with respect to the transactions.[851] The Examiner considers these matters below.

1. Examiner's Conclusions and Explanation Concerning Satisfaction of Exchangeable EGI-TRB Note.

Examiner's Conclusions:

It is unclear whether satisfaction of the Exchangeable EGI-TRB Note constitutes a preferential transfer. Even if, however, satisfaction of the Exchangeable EGI-TRB Note qualifies as a preferential transfer, it is reasonably likely that a court would find that the transaction is subject to an ordinary course of business defense, but it is unclear whether a court would find that the transaction is subject to a new value defense.

Explanation of Examiner's Conclusions:

The EGI-TRB Purchase Agreement provided for Tribune's issuance of two unsecured subordinated promissory notes: the Exchangeable EGI-TRB Note and the Initial EGI-TRB Note, which EGI-TRB agreed to purchase subject to the satisfaction of certain terms and conditions. On April 23, 2007, over one month before the Step One Financing Closing Date, EGI-TRB acquired the Exchangeable EGI-TRB Note for $200,000,000 in consideration as specified in the EGI-TRB Purchase Agreement. The Exchangeable EGI-TRB Note was an unsecured subordinated promissory note that was exchangeable into Tribune Common Stock and due and payable immediately prior to consummation of the Merger.

[851] Bankruptcy Code section 547(b) provides that a trustee or debtor in possession may avoid the transfer of an interest of the debtor in property (i) to or for the benefit of a creditor; (ii) for or on account of an antecedent debt owed by the debtor to the creditor before such transfer was made; (iii) made while the debtor was insolvent; (v) on or within ninety days before the date of the filing of the petition or between ninety days and one year before the date of the filing of the petition if made to an insider; and (vi) that enables the creditor to receive more than would be received as a distribution in a hypothetical Chapter 7 liquidation had the transfer not been made. *See* 11 U.S.C. § 547(b) (2006).

On December 20, 2007, in connection with consummation of the Merger, EGI-TRB purchased the Initial EGI-TRB Note in a transaction under which the Exchangeable EGI-TRB Note was satisfied and EGI-TRB advanced additional sums to Tribune. In this subsequent transaction, Tribune did not make cash transfers to EGI-TRB to satisfy the Exchangeable EGI-TRB Note. Rather, the outstanding amount of the Exchangeable EGI-TRB Note of $206,418,859.46 was netted against the face amount of the Initial EGI-TRB Note of $225,000,000, and additional sums owed between the parties[852] were similarly netted against each other.[853]

It is possible for a court to analyze and treat the Exchangeable EGI-TRB Note and Initial EGI-TRB Note in two distinct ways, each of which in turn affects whether the transaction may have resulted in an avoidable preference. First, a court might find that the Exchangeable EGI-TRB Note and Initial EGI-TRB Note were substantively the same obligation created pursuant to

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[852] At the time of the transaction, EGI-TRB owed a net debt of $56,081,148.54 to Tribune. Tribune was obligated to EGI-TRB for (i) outstanding amounts owed under the Exchangeable EGI-TRB Note of $206,418,859.46, (ii) Merger Consideration owed to EGI-TRB on account of its ownership of Tribune Common Stock in the amount of $49,999,992, and (iii) reimbursement of expenses incurred by EGI-TRB under the EGI-TRB Purchase Agreement in the amount of $2,500,000. EGI-TRB in turn was obligated to Tribune for (i) the purchase price of the Initial EGI-TRB Note in the amount of $225,000,000 and (ii) the purchase price of the Warrant in the amount of $90,000,000. *See* Ex. 714 at 4 (Step Two Flow of Funds Memorandum).

[853] The netting transactions may qualify as setoffs under Bankruptcy Code section 553. If treated as setoffs, the transactions are not subject to recovery as preferential transfers but are instead governed by Bankruptcy Code section 553. *See, e.g., Braniff Airways v. Exxon Co.*, 814 F.2d 1030, 1034 (5th Cir. 1987) ("When § 553 is determined to be applicable, § 547 cannot thereafter be utilized to undo its effect. The enactment of § 553 was an expression of the Congressional intent sanctioning the exercise of setoff as a permissible preference under certain circumstances."); *Comer v. U.S. Soc. Sec. Admin. (In re Comer)*, 386 B.R. 607, 608-609 (Bankr. W.D. Va. 2008) ("In order for there to be a preferential transfer under 11 U.S.C. § 547(b), there is a requirement of a pre-petition 'transfer' of an interest of the debtor in property. Transfer is a term of art which is defined in 11 U.S.C. § 101(54). The term 'setoff' is omitted from the definition of transfer in 11 U.S.C. § 101(54). The legislative history to 11 U.S.C. § 101(54) explains the omission in clear terms: inclusion of 'setoff' is deleted. The effect is that a 'setoff' is not subject to being set aside as a preferential 'transfer' but will be subject to special rules.'") (internal citations omitted); *Cain v. Mappa*, 142 B.R. 677, 686 (Bankr. D.N.J. 1992) ("When a setoff right is being asserted, § 553 rather than § 547 governs the creditor's rights.") (citing *Lee v. Schweiker,* 739 F.2d 870, 873 (3d Cir. 1984)); *In re Santoro Excavating, Inc.*, 32 B.R. 947, 950 (Bankr. S.D.N.Y. 1983) ("By equating setoff with secured claims, the Code recognizes that a permitted setoff is, in effect, an allowed preference."). The Examiner evaluates whether satisfaction of the Exchangeable EGI-TRB Note was a preferential transfer in the event a court were to find that the netting transactions were not setoffs. The Parties have not raised, and the Examiner has not analyzed, whether the netting transactions were recoupments, and if so, the possible impact on the preference analysis.

the transaction initiating and culminating in the Merger. Under the EGI-TRB Purchase Agreement, Tribune was obligated to repay the Exchangeable EGI-TRB Note and replace it with the Initial EGI-TRB Note when the Merger occurred. Once that condition was satisfied, the Initial EGI-TRB Note functioned identically to an amended and restated version of the Exchangeable EGI-TRB Note, albeit extending the maturity date and increasing the principal amount by $25,000,000 (representing the additional consideration due from EGI-TRB). Tribune did not transfer any cash to EGI-TRB when the Exchangeable EGI-TRB Note was satisfied and the Initial EGI-TRB Note was issued. If a court were to view the Initial EGI-TRB Note as a de facto amendment to the Exchangeable EGI-TRB Note under which EGI-TRB made a subsequent advance of $25,000,000 pursuant to the EGI-TRB Purchase Agreement, it would follow that issuance of the Initial EGI-TRB Note did not result in any transfer during the one-year reach-back period applicable to transfers to insiders.[854] Moreover, because the replacement of the Exchangeable EGI-TRB Note with the Initial EGI-TRB Note did not deplete or diminish Tribune's available assets, a court might view the transaction as not involving the transfer of an interest of Tribune in property that could be subject to recovery as a preference.[855]

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[854] *See* 11 U.S.C. § 547(b)(4)(B) (2006). Certain Parties have assumed that EGI-TRB would qualify as an insider of Tribune. The Warrant purchased by EGI-TRB would permit it to buy 43,478,261 shares of Tribune Common Stock (subject to anti-dilution adjustments), but EGI-TRB had not exercised the Warrant. *See* Ex. 157 at § 1(a) and (b) (Warrant). However, Samuel Zell was appointed to the Tribune Board on May 9, 2007. *See* Ex. 4 at 46 (Tribune 2007 Form 10-K).

[855] Although the Bankruptcy Code does not expressly mention depletion of the estate as an element of a preferential transfer, some courts have read this requirement into the law. *See, e.g., AmeriServe Food Distrib., Inc. v. Transmed Foods, Inc. (In re AmeriServe Food Distrib., Inc.)*, 315 B.R. 24, 29 (Bankr. D. Del. 2004) ("Section 547(b) requires, inter alia, that the property transferred by the debtor be an 'interest of the debtor in property.' The Supreme Court has interpreted this to be 'property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings.' In determining whether a transfer was 'an interest of the debtor in property,' courts apply the 'diminution of estate doctrine,' under which a transfer of an interest of the debtor occurs when a transfer 'diminishes directly or indirectly the fund to which creditors of the same class can legally resort for the payment of their debts, to such an extent that it is impossible for other creditors of the same class to obtain as great a percentage as the favored one.'") (internal citations omitted).

Second, a court might view the Initial EGI-TRB Note as a separate and distinct instrument from the Exchangeable EGI-TRB Note. There is no question that Tribune issued separate promissory notes representing the Exchangeable EGI-TRB Note and, subsequently, the Initial EGI-TRB Note. Although cash was not exchanged when Tribune satisfied the Exchangeable EGI-TRB Notes in connection with the Merger, the Exchangeable EGI-TRB Note did represent an obligation that Tribune was required to repay. Had the Merger not occurred, the Exchangeable EGI-TRB Note would never have been replaced by the Initial EGI-TRB Note. Viewed in this manner, when Tribune satisfied the Exchangeable EGI-TRB Note during the one-year reach-back period applicable to transfers to insiders, a transfer occurred on account of an antecedent debt, thereby giving rise to a prima facie preferential transfer.

Nevertheless, even if a court were to view the satisfaction of the Exchangeable EGI-TRB Note as a preferential transfer, it is reasonably likely that even in this circumstance any such transfer would be protected from avoidance under the ordinary course of business defense. The ordinary course of business defense permits a creditor to retain an otherwise avoidable preference if the transfer was made in payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and creditor and the transfer was either (i) made in the ordinary course of business of the parties or (ii) made according to ordinary business terms.[856] In evaluating whether the transfer was in payment of a debt incurred in the ordinary course of business of the debtor and creditor, courts typically consider the circumstances related to the debt, including whether it was incurred in a normal arms-length commercial transaction

[856] *See* 11 U.S.C. § 547(c)(2) (2006); *see also Miller v. Westfield Steel, Inc. (In re Elrod Holdings Corp.)*, 426 B.R. 106, 110 (Bankr. D. Del. 2010) ("Under 11 U.S.C. § 547(c)(2), the 'ordinary course of business exception' permits a creditor to retain transfers made by a debtor to a creditor during the ninety days before the petition date if: (1) such transfers were made for a debt incurred in the 'ordinary course of business' of the parties; and either (2) the transfers were made in the 'ordinary course of business' of the parties; or (3) the transfers were made in accordance with 'ordinary business terms.'").

conducted between the parties[857] or in the routine operation of the business of the debtor and creditor.[858] To establish whether a transfer was made in the ordinary course of business of the debtor and creditor, courts analyze the course of dealing between the parties and the circumstances of the particular transfers to determine if they are consistent with prior practices.[859] When the course of dealing between the debtor and creditor is limited, the court

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[857] *See, e.g., Kapila v. Media Buying, Inc. (In re Ameri P.O.S., Inc.)*, 355 B.R. 876, 883 (Bankr. S.D. Fla. 2006) ("Typically, this inquiry requires the Court to determine whether there is anything unusual about the transactions underlying the preferential payment. Courts have examined the following factors in making this determination (i) was the debt typical and (ii) was it incurred at arms length in the marketplace.") (internal citation omitted); *Huffman v. N.J. Steel Corp. (In re Valley Steel Corp.)*, 182 B.R. 728, 735 (Bankr. W.D. Va. 1995) ("[C]ourts generally are interested in whether or not the debt was incurred in a typical, arms-length commercial transaction that occurred in the marketplace, or whether it was incurred as an insider arrangement with a closely-held entity."); *see also Caillouet v. First Bank & Trust (In re Entringer Bakeries Inc.)*, 548 F.3d 344, 352 (5th Cir. 2008) (affirming finding that loan was not made in ordinary course of business of lender when made on non-conforming basis and terms inconsistent with lending policies); *Speco Corp. v. Canton Drop Forge (In re Speco Corp.)*, 218 B.R. 390, 398 (Bankr. S.D. Ohio 1998) ("In contrast, a debt will be considered not incurred in the ordinary course of business if creation of the debt is atypical, fraudulent, or not consistent with an arms-length commercial transaction.").

[858] *See, e.g., Elrod Holdings*, 426 B.R. at 111 (analyzing businesses of debtor and creditor to determine whether debt incurred in ordinary course of business); *Wilen v. Pamrapo Sav. Bank, S.L.A. (In re Bayonne Med. Ctr.)*, 429 B.R. 152, 188 (Bankr. D.N.J. 2010) ("The preamble requirement of § 547(c)(2) focuses on the *debt* for which the challenged transfer was payment. In this case, the inquiry is whether the credit line loan was provided by the bank in the ordinary course of its business, and so undertaken by the [debtor]."); *Off. Comm. of Unsecured Creditors v. Charleston Forge, Inc. (In re Russell Cave Co.)*, 259 B.R. 879, 882 (Bankr. E.D. Ky. 2001) (establishing that transfer is in payment of debt incurred in ordinary course of business "is demonstrated relatively easily by a showing that each party was engaged in its usual business when the debt was incurred and the transfer took place"); *Youthland, Inc. v. Sunshine Girls (In re Youthland, Inc.)*, 160 B.R. 311, 314 (Bankr. S.D. Ohio 1993) ("The first element of § 547(c)(2) requires an examination of the debts incurred for which the transfers were payment for the normality of such incurrences in each party's business operations generally."); *Pioneer Tech., Inc. v. Eastwood (In re Pioneer Tech., Inc.)*, 107 B.R. 698, 702 (B.A.P. 9th 1988) ("Courts have consistently held that the section was intended to protect *ordinary trade credit* transactions, and not those outside the normal course of either the debtor's or creditor's business."). *But see Fitzpatrick v. Cent. Commc'ns & Elecs., Inc. (In re Tenn. Valley Steel Corp.)*, 203 B.R. 949, (Bankr. E.D. Tenn. 1996) ("This analysis . . . looks to whether the debt was incurred in the ordinary course of business between the parties, as opposed to a determination of whether the debt was incurred in the ordinary course of each party's business, as viewed separate from their dealings with one another. As such, this court will apply the approach that looks to whether the debt was incurred in the ordinary course of business *between* the parties."); *Redmond v. Ellis County Abstract & Title Co. (In re Liberty Livestock Co.)*, 198 B.R. 365, 373 (Bankr. D. Kan. 1996) ("It is a subjective test. Even if the creditor is not a traditional lender, if the transaction was ordinary as between this particular debtor and creditor, then it was in the ordinary course of their business.").

[859] *See, e.g., U.S. Tr. v. First Jersey Sec., Inc. (In re First Jersey Sec., Inc.)*, 180 F.3d 504, 512 (3d Cir. 1999) ("[T]he determination of what is 'in the ordinary course of business' is subjective, calling for the Court to consider whether the transfer was ordinary as between the debtor and the creditor. Factors such as timing, the amount and manner in which a transaction was paid are considered relevant."); *Elrod Holdings*, 426 B.R. at 111 ("To make this determination, courts consider factors such as: (1) the length of time the parties engaged in the type of dealing at issue; (2) whether the subject transfers were in an amount more than usually paid; (3) whether the payments at issue were tendered in a manner different from previous payments; (4) whether there appears to

may instead rely on the terms of the agreement to establish the ordinary course of business between the parties.[860] A transfer may be made on ordinary business terms when it is consistent with the range of terms prevailing in the relevant industry of the debtor and creditor.[861]

Although the transaction giving rise to the repayment of the Exchangeable EGI-TRB Note was a one-time event for both Tribune and EGI-TRB, this does not necessarily mean that it was outside the ordinary course of business.[862] Because the prior course of dealing between

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have been an unusual action by the debtor or creditor to collect on or pay the debt; and (5) whether the creditor did anything to gain an advantage (such as gain additional security) in light of the debtor's deteriorating financial condition.") (citing *In re Forklift LP Corp.*, 340 B.R. 735, 738-39 (Bankr. D. Del. 2006)).

[860] *See, e.g., Kleven v. Household Bank F.S.B.*, 334 F.3d 638, 643 (7th Cir. 2003) ("In some instances, and this is one, the ordinary course of business may be established by the terms of the parties' agreement, until that agreement is somehow or other modified by actual performance. In the absence of modifying behavior, we see no reason why we should not look to the terms of the parties' agreement in order to determine their ordinary course of business."); *Payne v. Clarendon Nat'l Ins. Co. (In re Sunset Sales)*, 220 B.R. 1005, 1021 (B.A.P. 10th Cir. 1998) ("In the absence of any prior transactions, courts typically look to see if the debtor complied with the payment terms of its contract."); *Warsco v. Household Bank F.S.B. (In re Various Cases)*, 272 B.R. 246, 251-252 (Bankr. N.D. Ind. 2002) ("Nonetheless, in the absence of such a history, there seems to be no good reason not to look to the terms of the parties' agreement in order to determine their ordinary course of business."); *In re Keller Tool Corp.*, 151 B.R. 912, 914 (Bankr. E.D. Mo. 1993) ("When, as here, the record has established that the Debtor and the Defendant had no business dealings prior to the transaction that is the subject of this proceeding, the Court may look to the parties' ordinary course of dealings in other business transactions. Initially, however, the Court must examine the course of business dealings between the Debtor and the Defendant as it may be established by the documents and other evidence that appear from the record.") (internal citation omitted).

[861] *See, e.g., Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.)*, 18 F.3d 217, 224-26 (3d Cir. 1994); *Forklift*, 340 B.R. at 738-39 ("[T]he creditor is not required to prove rigorous definitions of either the industry or the credit standards within that industry. The creditor must establish, however, a 'range of terms' on which 'firms similar in some general way to the creditor' deal. The court, therefore, is directed to make three inquiries in this regard. First, the court must consider 'the range of terms on which firms comparable to [the creditor] on some level provide credit to firms comparable to the debtor on some level.' Second, the court must consider 'the length of the parties' relationship predating the debtor's insolvency to estimate the size of the customized window surrounding the industry norm which was established in the first step.' Finally, the court inquires 'whether the relationship remained relatively stable leading into and throughout the insolvency period.'") (quoting *Molded Acoustical Prods.*, 18 F.3d at 227-28) (internal citations omitted); *see also Ganis Credit Corp. v. Anderson (In re Jan Weilert RV, Inc.)*, 315 F.3d 1192, 1198 (9th Cir. 2003) ("Only a transaction that is so unusual or uncommon 'as to render it an aberration in the relevant industry,' falls outside the broad range of terms encompassed by the meaning of 'ordinary business terms.'") (internal citation omitted). The Parties have not suggested that the transaction could qualify as a transfer made on ordinary business terms in the industry of Tribune and EGI-TRB.

[862] *See, e.g., In re Finn*, 909 F.2d 903, 908 (6th Cir. 1990) ("Obviously every borrower who does something in the ordinary course of her affairs must, at some point, have done it for the first time. We hold that . . . a transaction can be in the ordinary course of financial affairs even if it is the first such transaction undertaken by the customer."); *Compton v. Plain Mktg., LP (In re Tri-Union Dev. Corp.)*, 349 B.R. 145, 150 (Bankr. S.D. Tex. 2006) ("[A] singular event may be ordinary for the purposes of § 547(c)(2)(B)."); *Roberds, Inc. v. Broyhill Furniture (In re Roberds, Inc.)*, 315 B.R. 443, 458 (Bankr. S.D. Ohio 2004) ("[A]n appropriate ordinary course

Tribune and EGI-TRB also was limited, the terms of the Exchangeable EGI-TRB Note are the most relevant consideration when determining whether an ordinary course of business defense may be asserted.[863] Here, the Exchangeable EGI-TRB Note was due and payable immediately before consummation of the Merger. At the time of the transaction, Tribune and EGI-TRB complied with the requirements of the Exchangeable EGI-TRB Note, and the obligation was satisfied in accordance with its terms; moreover, there is no evidence that anything unusual occurred between the parties in connection with the transaction.[864] As a result, a court is reasonably likely to find that these circumstances support a conclusion that any transfer made to satisfy the Exchangeable EGI-TRB Note qualifies for an ordinary course of business defense.

Certain Parties have also suggested that EGI-TRB provided "new value" in connection with the transaction that could shield any transfer from avoidance. Under the new value defense,

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analysis requires a recognition that a variety of events in the course of the parties' business history may be found ordinary, even though these events never occurred in the parties' history."); *Bohm v. Golden Knitting Mills, Inc. (In re Forman Enters.)*, 293 B.R. 848, 857 (Bankr. W.D. Pa. 2003) ("A first-time transaction between a debtor and a creditor in certain circumstances may qualify as an ordinary course transaction . . . ."); *Huffman v. N.J. Steel Corp. (In re Valley Steel Corp.)*, 182 B.R. 728, 735 (Bankr. W.D. Va. 1995) ("[A] first time transaction is no less susceptible of qualifying for the ordinary course of business exception than a transaction that has occurred frequently in the past."). *But see Off. Comm. of Unsecured Creditors of Enron Corp. v. Martin (In re Enron Creditors Recovery Corp.)*, 376 B.R. 442, 462 (Bankr. S.D.N.Y. 2007) ("Therefore, it appears for a 'first time' transfer to qualify for application of the defense, it should be a type that could have been a 'recurring, customary trade transaction' had the parties continued their business relationship—not a single isolated transaction that would never have been repeated in any case.").

863 As noted below, although there is some authority for the proposition that debt arising from a leveraged buyout is not incurred in the ordinary course of business, the Examiner believes it is appropriate to consider the circumstances under which the debt was incurred and related criteria, including whether the transaction was conducted at arms-length. In this case, there is no evidence indicating that the transaction between Tribune and EGI-TRB was conducted at less than arms-length.

864 *See, e.g., Forman Enters.*, 293 B.R. at 858 (following suggestion of other courts that "we should examine the conduct of the parties to determine whether either of them did anything unusual or extraordinary with respect to the transfer made in payment of the underlying debt. If nothing unusual or untoward occurred, there is no good reason to conclude that the transfer was out of the ordinary."); *Warsco v. Household Bank F.S.B. (In re Various Cases)*, 272 B.R. 246, 252 (Bankr. N.D. Ind. 2002) ("Each transaction at issue, including the first-time transactions between [the creditor] and a particular debtor, was conducted strictly in accordance with the terms of the parties' written agreement. This included the timing and the manner in which [the creditor] applied the funds from each debtors' account to the loan balance. Consequently, the court concludes that even the first-time transactions were ordinary as between the parties.").

transfers are not avoidable when a creditor extends new value[865] to or for the benefit of the debtor after receiving the transfer, such new value is not secured by an unavoidable security interest, and such new value has not been repaid with an otherwise unavoidable transfer.[866] Applied here, when Tribune paid the Exchangeable EGI-TRB Note, EGI-TRB in turn advanced to Tribune a greater amount under the Initial EGI-TRB Note that was never repaid,[867] thereby potentially giving rise to a new value defense.[868]

A court, however, may well conclude that EGI-TRB did not advance new value to Tribune because EGI-TRB already was contractually obligated to purchase the Initial EGI-TRB Note months before the transaction,[869] and the simultaneous effect of the transaction did not

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[865] The term "new value" is defined to include "money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation." 11 U.S.C. § 547(a)(2) (2006).

[866] *See* 11 U.S.C. § 547(c)(4) (2006). *See also N.Y. City Shoes, Inc. v. Bentley Int'l, Inc. (In re N.Y. City Shoes, Inc.)*, 880 F.2d 679, 680 (3d Cir. 1989) ("The three requirements of section 547(c)(4) are well established. First, the creditor must have received a transfer that is otherwise voidable as a preference under § 547(b). Second, *after* receiving the preferential transfer, the preferred creditor must advance 'new value' to the debtor on an unsecured basis. Third, the debtor must not have fully compensated the creditor for the 'new value' as of the date that it filed its bankruptcy petition."). The third element of the new value defense as stated by the Third Circuit Court of Appeals should not be interpreted broadly to preclude "full compensation" per se, but only to circumstances in which the new value has been repaid with an otherwise unavoidable transfer. *See, e.g., Wahoski v. Am. & Efrid, Inc. (In re Pillowtex Corp.)*, 416 B.R. 123, 129 (Bankr. D. Del. 2009) ("A creditor who raises the § 547(c)(4) defense has the burden of proving that: '(1) new value was extended after the preferential payment sought to be avoided, (2) the new value is not secured with an otherwise unavoidable security interest and (3) the new value has not been repaid *with an otherwise unavoidable transfer*.'") (quoting *Laker v. Vallette (In re Toyota of Jefferson, Inc.)*, 14 F.3d 1088, 1093 n.2 (5th Cir. 1994)).

[867] *See, e.g., Off. Comm. of Unsecured Creditors v. Tennenbaum Capital Partners (In re Radnor Holdings Corp.)*, 353 B.R. 820, 848 (Bankr. D. Del. 2006) ("A creditor provides new value when it makes a loan to the debtor.").

[868] *See, e.g., Off. Comm. of Unsecured Creditors of R.M.L., Inc. v. Conceria Sabrina, S.P.A. (In re R.M.L., Inc.)*, 195 B.R. 602, 616 (Bankr. M.D. Pa. 1996) ("In order to calculate the amount of new value to be applied against preferential payments, most courts apply a 'subsequent advance' method of calculation. The method 'looks at the 90-day preference period and calculates the difference between the total preferences and the total advances, provided that each advance is used to offset only prior (although not necessarily immediately prior) preferences.'") (quoting *In re Meredith Manor, Inc.,* 902 F.2d 257, 259 (4th Cir. 1990)).

[869] *See, e.g., Gouveia v. RDI Grp. (In re Globe Bldg. Materials, Inc.)*, 484 F.3d 946, 950 (7th Cir. 2007) (holding that performance of existing contractual obligation does not constitute new value).

actually result in a *subsequent* advance of new value to Tribune.[870] Under Bankruptcy Code section 547(a)(2), "new value" includes "new credit," but does not include "an obligation substituted for an existing obligation."[871] Between these two views, the Examiner concludes that a court is reasonably likely to find that new value was not advanced because EGI-TRB performed its preexisting contractual obligation to purchase the Initial EGI-TRB Note and, alternatively, largely substituted an obligation for an existing obligation.

2. Examiner's Conclusions and Explanation Concerning Payments on Account of Bridge Debt and Credit Agreement Debt.

Examiner's Conclusions:

To the extent that payments to the LBO Lenders on account of the Bridge Debt and Credit Agreement Debt qualified as preferential transfers, it is reasonably likely that a court would find that the payments could be subject to an ordinary course of business defense, except to the extent that the underlying Bridge Debt and Credit Agreement Debt are avoided as fraudulent transfers.

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[870] *See, e.g., N.Y. City Shoes, Inc.*, 880 F.2d at 680 (3d Cir. 1989) ("[*A*]*fter* receiving the preferential transfer, the preferred creditor must advance 'new value' to the debtor on an unsecured basis."). Viewed in this fashion, the transfer might instead be shielded from avoidance as a contemporaneous exchange of new value. "Under Bankruptcy Code Section 547(c)(1), a transfer is not a preference if it was '(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and (B) in fact a substantially contemporaneous exchange.'" *Off. Comm. of Unsecured Creditors v. Tennenbaum Capital Partners (In re Radnor Holdings Corp.)*, 353 B.R. 820, 847-48 (Bankr. D. Del. 2006). In certain circumstances, the advance of credit to satisfy existing debts may qualify as a contemporaneous exchange of new value. *See, e.g., In re Arrow Air, Inc.*, 940 F.2d 1463, 1466 (11th Cir. 1991) ("As we have indicated in the past, that a transfer from debtor to creditor is payment of a pre-existing debt does not automatically preclude the transfer from also being a contemporaneous exchange for new value. And, under appropriate circumstances, the new value exchanged for the transfer or payment may take the form of new credit. Therefore, it is not impossible, as a matter of law, that an extension of new credit by [a creditor] to [a debtor] could have constituted 'new value.'") (internal citations omitted); *Radnor Holdings Corp.*, 353 B.R. at 847-48 ("Even if some of the new value is used by a debtor to pay pre-existing debt, the transfer falls within the four corners of 11 U.S.C. § 547(c)(1) if the amount transferred to the debtor exceeds the amount repaid on pre-existing debt."). As noted, however, a court could conclude that EGI-TRB's performance of the preexisting contractual obligation to purchase the Initial EGI-TRB Note was not intended by the parties to be a contemporaneous exchange for new value and did not constitute new value.

[871] 11 U.S.C. § 547(a)(2) (2006).

Explanation of Examiner's Conclusions:

Payments on indebtedness such as the LBO Lender Debt may also qualify as ordinary course of business transactions[872] when made in a manner consistent with the terms of the underlying agreements and prior practice between the parties.

The Examiner, with the assistance of his financial advisors, has analyzed the payments made by Tribune on account of the Credit Agreement Debt and the Bridge Debt for the period from December 2007 through the Petition Date by identifying the relevant payment due dates, payment receipt dates, and payment sources and methods. A schedule of that information is attached as Annex C to this Volume of the Report. As reflected therein, during the ninety-day period before the Petition Date, as demonstrated in the foregoing table, Tribune paid approximately $141,130,270 on account of the Credit Agreement Debt and approximately $34,570,444 on account of the Bridge Debt. Comparing the payments made during the preference period to preceding periods, the payment history is generally consistent and does not demonstrate any material deviation in payment dates, sources, methods or amounts. Similar to previous practice, the payments made by Tribune during the preference period ranged between two days before and four days after their respective due dates under the Bridge Credit Agreement and Credit Agreement, with the majority of payments being made when due. There was no evidence that payments were accelerated or delayed or otherwise made in a manner inconsistent with the terms of the Bridge Credit Agreement and Credit Agreement or prior practice of the parties.[873]

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872 *See, e.g., Union Bank v. Wolas*, 502 U.S. 151, 162 (1991) ("[P]ayments on long-term debt, as well as payments on short-term debt, may qualify for the ordinary course of business exception.").

873 *See, e.g., Liebersohn v. WTAE-TV (In re Pure Weight Loss, Inc.)*, No. 08-10315, 2009 Bankr. LEXIS 3956, at *14-*15 (Bankr. E.D. Pa. Nov. 10, 2009) ("An important indicator to determine ordinary course of business is whether the timing of the preference period payments was consistent with the timing of similar payments during the pre-preference period."); *Montgomery Ward, LLC v. OTC Int'l, LTD. (In re Montgomery Ward, LLC)*, 348

In light of the foregoing circumstances, the Examiner concludes that a court is reasonably likely to find that payments to the LBO Lenders that otherwise constitute preferential transfers would be subject to an ordinary course of business defense, except to the extent that the underlying Bridge Debt and Credit Agreement Debt are avoided as fraudulent transfers. Although one court has suggested that indebtedness incurred in connection with a leveraged buyout transaction is ineligible for an ordinary course of business defense,[874] the Examiner believes that a narrow focus on the purpose of the debt is inappropriate and inconsistent with the approach taken by the majority of courts that properly considers the circumstances under which the debt was incurred and related factors.[875]

3. Examiner's Conclusions and Explanation Concerning Payments to Directors and Officers of Tribune Entities.

Certain Parties noted that bonuses, deferred compensation, retention, severance, and change in control payments made to directors and officers of the Tribune Entities during the one-year period prior to the Petition Date[876] could potentially qualify as preferential transfers. Depending on the circumstances, these payments may or may not qualify as preferences and

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B.R. 662, 673-74 (Bankr. D. Del. 2006) ("Determining whether the disputed transaction is consistent with the course of dealing between the respective parties is an inherently factual analysis. The Defendant must establish a 'baseline of dealing' so that the court may compare the transfers made during the preference period with the parties' prior course of dealings.") (internal citation omitted).

874 *See, e.g., Mellon Bank, N.A. v. Metro Commc'ns, Inc. (In re Metro Commc'ns, Inc.)*, 95 B.R. 921, 931 (Bankr. W.D. Pa. 1989) (stating that "the LBO/stock purchase loan is highly extraordinary in nature and no company's borrowing to allow for the purchase of its own stock could ever be considered part of the ordinary course of its business"), *aff'd in part and rev'd in part*, 135 B.R. 15 (W.D. Pa.), *rev'd on other grounds*, 945 F.2d 635 (3d Cir. 1991). Notably, the court in *Metro Communications* also concluded that the leveraged buyout was a fraudulent transfer, so it is not surprising the court held that the related indebtedness was incurred outside the ordinary course of business. 95 B.R. at 934. *See also Speco Corp. v. Canton Drop Forge (In re Speco Corp.)*, 218 B.R. 390, 398 (Bankr. S.D. Ohio 1998) ("In contrast, a debt will be considered not incurred in the ordinary course of business if creation of the debt is atypical, fraudulent, or not consistent with an arms-length commercial transaction.").

875 *See, e.g., Kapila v. Media Buying, Inc. (In re Ameri P.O.S., Inc.)*, 355 B.R. 876, 882-884 (Bankr. S.D. Fla. 2006); *Huffman v. N.J. Steel Corp. (In re Valley Steel Corp.)*, 182 B.R. 728, 735 (Bankr. W.D. Va. 1995).

876 To the extent they weighed in on this question, the Parties have treated this group as "insiders" of the Tribune Entities. *See* 11 U.S.C. §§ 101(31)(B)(i)-(ii) and 547(b)(4)(B) (2006). The Examiner therefore did not investigate this question.

could also be subject to an ordinary course of business defense that would make them unavoidable.[877] These issues were only briefly mentioned and insufficiently developed by the Parties, and a thorough analysis would require a detailed review of multiple payments to more than two hundred individuals. The time period of the Investigation and available resources did not permit the Examiner an opportunity to examine and analyze these transfers and reach a definitive conclusion.

4. Examiner's Conclusions and Explanation Concerning Intercompany Payments.

Another Party suggested that Tribune may hold preferential transfer claims against its subsidiaries arising from intercompany transactions, but did not submit any analysis or evidence to support the allegation. To properly analyze these issues and reach a conclusion regarding the viability of any such claims, including applicable defenses such as an ordinary course of business defense, would demand an examination of the many thousands of transactions occurring among Tribune and more than one hundred subsidiaries over a one-year period, and require substantial efforts and months to complete. Moreover, the Examiner would have to determine the nature of the intercompany obligations. Only if the intercompany obligations are debts will a preference action be implicated.[878] Payments on account of equity investments, such as capital infusions or contributions, may implicate fraudulent transfers but would not constitute potential preferential

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[877] *See, e.g., Off. Comm. of Unsecured Creditors of Enron Corp. v. Martin (In re Enron Creditors Recovery Corp.)*, 376 B.R. 442, 462-63 (Bankr. S.D.N.Y. 2007) (holding that severance payments did not qualify for ordinary course of business defense); *Grigsby v. Carmell (In re Apex Auto. Warehouse, L.P.)*, 238 B.R. 758, 775 (Bankr. N.D. Ill. 1999) (holding that bonus payments did not qualify for ordinary course of business defense and noting that "[a] bonus by its very nature is something out of the ordinary"); *Hassett v. Goetzmann (In re CIS Corp.)*, 195 B.R. 251, 257 (Bankr. S.D.N.Y. 1996) (holding that bonus payments did not qualify for ordinary course of business defense); *Intercont. Publ'ns, Inc. v. Perry (In re Intercont. Publ'ns, Inc.)*, 131 B.R. 544, 550 (Bankr. D. Conn. 1991) (holding that severance payments did not qualify for ordinary course of business defense). *But see NMI Sys. v. Pillard (In re NMI Sys., Inc.)*, 179 B.R. 357, 372-74 (Bankr. D.D.C. 1995) (holding that bonus payments qualified for ordinary course of business defense).

[878] *See* 11 U.S.C. § 547(b)(2) (2006) (preferential transfer must be "for or on account of an antecedent debt owed by the debtor before such transfer was made").

transfers. The Examiner was unable to investigate these matters given the limited time in which to conduct the Investigation.

D. Equitable Subordination/Equitable Disallowance of Specified Claims.

1. Generally.

Bankruptcy Code section 510(c) provides that a court may:[879]

> (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or (2) order that any lien securing such a subordinated claim be transferred to the estate.

In *Benjamin v. Diamond (In re Mobile Steel Company)*, the Fifth Circuit Court of Appeals formulated a three-factor test that has been followed by courts across the country: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must be consistent with the provisions of the Bankruptcy Code.[880] Equitable subordination permits claims to be equitably subordinated to other claims, and interests subordinated to other interests, but does not authorize the subordination of claims to interests.[881] Moreover, although courts have not required that the inequitable conduct warranting subordination of a creditor's claim be related to the acquisition or

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[879] 11 U.S.C. § 510(c) (2006). *See Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims*, 323 F.3d 228, 233 (3d Cir. 2003).

[880] *See Rosener v. Majestic Mgmt., Inc. (In re OODC, LLC)*, 321 B.R. 128, 145 (Bankr. D. Del. 2005) (citing *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977)).

[881] *See, e.g.*, *See Schubert v. Lucent Techs. Inc. (In re Winstar Commc'ns, Inc.) (Schubert II)*, 554 F.3d 382, 390, 392, 414 (3d Cir. 2009); *Shearer v. Tepsic (In re Emergency Monitoring Techs., Inc.)*, 366 B.R. 476, 504 (Bankr. W.D. Pa. 2007) (concluding that section 510(c) only authorizes the subordination of claims to other claims or interests to other interests, but does not allow subordination of claims to interests) (citing *Acropolis Enters., Inc. v. CR Amusements, LLC (In re C.R. Amusements LLC)*, 259 B.R. 523, 529 (Bankr. D.R.I. 2001)).

It appears that no published cases address whether Bankruptcy Code section 510(c) can be used to override a contractual subordination agreement under section 510(a), but the text of the statute seems to suggest such a possibility. The precise language of section 510(c) provides that "*[n]otwithstanding* subsections (a) and (b)" of section 510 of the statute, a court may equitably subordinate a claim. 11 U.S.C. § 510(c) (2006) (emphasis added).

assertion of that claim,[882] courts have cautioned that equitable subordination is an "extraordinary measure" which should not be lightly invoked.[883]

a. The Effect of Insider or Non-Insider Status.

In determining whether a claimant has engaged in "inequitable conduct" under the *Mobile Steel* formulation, a key preliminary inquiry is whether the claimant was an "insider" in relation to the debtor at the time of the conduct in question.[884] If the claimant is determined to be an insider, once the trustee initially demonstrates "material evidence of unfair conduct" by the claimant, the burden of proof shifts to the claimant to establish "the fairness of his transactions with the debtor;" if the claimant fails to carry that burden, its claim will be equitably subordinated.[885] Courts have recognized three categories of "unfair conduct" by insiders that may constitute "inequitable conduct" under the *Mobile Steel* test: (i) fraud, illegality, or breach of fiduciary duties; (ii) undercapitalization; and (iii) a claimant's use of the debtor as a mere instrumentality or alter ego.[886] In assessing whether a creditor is an insider, courts examine

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[882] *See, e.g.*, *In re Mid-Am. Waste Sys., Inc.*, 284 B.R. 53, 69 (Bankr. D. Del. 2002) (citing *Fabricators, Inc. v. Tech. Fabricators, Inc. (In re Fabricators, Inc.),* 926 F.2d 1458, 1467 n.14 1991 (5th Cir. 1991)). A separate question is whether a court may equitably subordinate a claim in the hands of a transferee when the transferee did not engage in wrong-doing. *See Enron Corp. v. Springfield Assocs., LLC (In re Enron Corp.)*, 379 B.R. 425, 427-28 (S.D.N.Y. 2007). The decision in *Enron* is discussed in another part of the Report in the context of avoidance. *See* Report at § IV.B.7.b.(2). It is unclear whether the holding will be followed in the equitable subordination context. The Examiner draws no conclusions in this regard, and notes only that the equation is unsettled.

[883] *See Bank of N.Y. v. Epic Resorts-Palm Springs Marquis Villas (In re Epic Capital Corp.)*, 290 B.R. 514, 525 (Bankr. D. Del. 2003) (citing *MB Ltd. P'ship v. Nutri/Sys. (In re Nutri/Sys., Inc.)*, 169 B.R. 854, 865 (Bankr. E.D. Pa. 1994)), *aff'd*, 178 B.R. 645 (E.D. Pa. 1995); *see also Cohen v. KB Mezzanine Fund II (In re SubMicron Sys. Corp.)*, 291 B.R. 314, 327, 329 (D. Del. 2003) (stating that equitable subordination is a "drastic" and "unusual" remedy), *aff'd*, 432 F.3d 448 (3d Cir. 2006).

[884] *See In re Mid-Am. Waste Sys., Inc.*, 284 B.R. at 69-70 (citing *Capitol Bank & Trust Co. v. 604 Columbus Ave. Realty Trust (In re 604 Columbus Ave. Realty Trust)*, 968 F.2d 1332, 1360 (1st Cir. 1992)); *see also Waslow v. MNC Commercial Corp. (In re M. Paolella & Sons, Inc.)*, 161 B.R. 107, 118 (E.D. Pa. 1993) (observing that courts differentiate between insider and non-insider claims in applying equitable subordination principles), *aff'd*, 37 F.3d 1487 (3d Cir. 1994); *Epic Capital Corp.*, 290 B.R. at 524 (same).

[885] *Ansel Props., Inc. v. Nutri/System Assocs. (In re Nutri/Sys. Assocs.)*, 178 B.R. 645, 657 (E.D. Pa. 1995) (citing *In re N & D Props., Inc.*, 799 F.2d 726, 731 (11th Cir. 1986)).

[886] *M. Paolella & Sons*, 161 B.R. at 117-18; *Mid-Am. Waste*, 284 B.R. at 70.

whether the creditor: (i) had greater ability to assert control than other creditors; (ii) made management decisions for the debtor; (iii) directed work performance; or (iv) directed payment of the debtor's expenses.[887] In this regard, the courts look for day-to-day control rather than monitoring activities or exertion of influence regarding financial transactions in which the creditor has a direct stake.[888]

If the claimant is not an insider or a fiduciary, the movant must demonstrate, with particularity, "gross" or "egregious" conduct by the claimant that is tantamount to "fraud, spoliation or overreaching" in order to satisfy the first prong of the *Mobile Steel* test.[889] In *In re Aluminum Mills Corp.*, for example, the court held that the allegation that a lender made a loan that it knew would result in insolvency and then acted strategically to maximize its own benefits was insufficient, without more, to demonstrate egregious misconduct on the part of the lender.[890] Although courts have rarely subordinated non-insider claims, the annals of bankruptcy law include instances in which courts have done so when presented with egregious creditor

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887 *Schubert v. Lucent Techs., Inc. (In re Winstar Commc'ns, Inc.) (Schubert I)*, 348 B.R. 234, 279 (Bankr. D. Del. 2005) (citing *ABC Elec. Serv. Inc. v. Rondout Elec., Inc. (In re ABC Elec. Serv. Inc.)*, 190 B.R. 672, 675 (Bankr. M.D. Fla. 1995)), *aff'd in part, mod. in part*, 554 F.3d 382 (3d Cir. 2009); *see also M. Paolella & Sons*, 161 B.R. at 118-19 (concluding that creditor was not an insider because it did not participate in the debtor's management, determine its operating decisions, or have any presence on its board); *Aluminum Mills Corp. v. Citicorp N. Am., Inc. (In re Aluminum Mills Corp.)*, 132 B.R. 869, 895 (Bankr. N.D. Ill. 1991) (holding that lender was an insider when lender had a security interest in 85% of debtor's stock, controlled a variety of key business decisions, and used its control to keep the debtor in business while the debtor was insolvent).

888 *Schubert I*, 348 B.R. at 279; *Off. Comm. of Unsecured Creditors of Radnor Holdings Corp. v. Tennenbaum Capital Partners, LLC (In re Radnor Holdings Corp.)*, 353 B.R. 820, 840-41 (Bankr. D. Del. 2006).

889 *See Sierra Invs., LLC v. SHC, Inc. (In re SHC, Inc.)*, 329 B.R. 438, 448 (Bankr. D. Del. 2005) (finding that debtors had sufficiently alleged facts showing fraud where lender had collaborated on eve of debtors' insolvency to enter into an assignment agreement without any consideration given to debtors); *Bank of N.Y. v. Epic Resorts-Palm Springs Marquis (In re Epic Capital Corp.)*, 290 B.R. 514, 524 (Bankr. D. Del. 2003).

890 *Aluminum Mills*, 132 B.R. at 896 (citing *In re Dry Wall Supply, Inc.*, 111 B.R. 933, 938-39 (D. Colo. 1990) ("In this case, the trustee simply alleges that Chase's predecessor knew or should have known that the loan transaction would render Dry Wall Supply, Inc. insolvent and that it was made without adequate consideration. There simply is no allegation or evidence that Chase committed gross misconduct by financing the leveraged buy-out of Dry Wall Supply, Inc."). Nonetheless, the court still held that the lender's claim could be equitably subordinated because the lender: (1) assumed the position of a fiduciary; (2) acted strategically to protect itself to the detriment of the debtor and unsecured creditors; and (3) engaged in fraud and overreaching, which in turn led to breaches of fiduciary duties. *Id.* at 896. *See also Radnor Holdings Corp.*, 353 B.R. at 840-41.

misconduct. In *Rosener v. Majestic Management, Inc. (In re OODC, LLC)*,[891] for example, the bankruptcy court concluded that a trustee had alleged sufficient facts to support claims against non-insider banks for actual and constructive fraud and aiding and abetting breach of fiduciary duty. The trustee alleged that the banks: (1) knowingly facilitated the removal of at least $40 million in assets of the debtor at a time when the debtor was insolvent; (2) knowingly and recklessly disregarded the debtor's insolvency; (3) knowingly and recklessly intended to hinder, delay, or defraud the debtor's creditors; (4) knowingly or recklessly disregarded the fact that a leveraged buyout would force the debtor into bankruptcy; and (5) knowingly and recklessly disregarded the cumulative impact of these transactions on the debtor's unsecured creditors. The court explained that, if proven, these allegations would provide the basis for a finding of egregious misconduct, which could warrant equitable subordination of the banks' claims.[892]

In *Murphy v. Meritor Savings Bank (In re O'Day Corp.)*,[893] the court equitably subordinated a non-insider lender's claims arising out of a failed leveraged buyout when: (1) the bank's financial projections were unreasonable; (2) the bank gave "little weight" to indications showing declines in company earnings leading up to the leveraged buyout; (3) the bank had full access to the debtor's records, facilities, and management; (4) there was a widely-recognized decline in the debtor's industry; (5) the bank proceeded with the loan even though the company did not own assets that comprised a significant portion of the collateral it sought; and (6) the bank engaged in egregious behavior after the transaction closed to improve its position at the expense of creditors.

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[891] 321 B.R. 128 (Bankr. D. Del. 2005).

[892] *Id.* at 146.

[893] *Murphy v. Meritor Sav. Bank (In re O'Day Corp.)*, 126 B.R. 370, 376, 380-81, 405-06, 412 (Bankr. D. Mass. 1991). Although the court characterized some of the trustee's allegations as "overstated," *id.* at 412, including directing the debtor to cease vendor payments, the court noted among other things that the bank's actions were "tantamount to overreaching." *Id.*

Finally, in *Credit Suisse v. Official Committee of Unsecured Creditors (In re Yellowstone Mountain Club, LLC)*,[894] the court found that the secured lender had devised a "loan scheme whereby it encouraged developers of high-end residential resorts . . . to take unnecessary loans." It made loans to the debtor that were passed directly to a principal shareholder and subsidiaries for purposes outside the scope of the debtor's business. The court observed that despite various "red flags" concerning the debtor's financial condition, the lender granted the debtor a substantial loan because "it was driven by the fees it was extracting from the loans it was selling, and letting the chips fall where they may."[895] Having "lined its pockets on the backs of the unsecured creditors," the lender's conduct was so far overreaching and self-serving so as to shock the court's conscience.[896] Concluding that the lender "turned a blind eye" to the debtor's financial records and could not have believed that the debtor could service such an increased debt load in light of its historical financial performance, the court held that equitable subordination of the lender's claim was appropriate.[897]

This triad of cases is illustrative of the level of egregious behavior that would justify equitable subordination of non-insider claims. In short, the behavior must be genuinely egregious.

2. Equitable Disallowance.

In *Pepper v. Litton,*[898] the Supreme Court embraced both equitable subordination and equitable disallowance as permissible remedies when the equities of a given case justify their

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894 *Credit Suisse v. Off. Comm. of Unsecured Creditors (In re Yellowstone Mountain Club, LLC)*, 2009 Bankr. LEXIS 2047, at *15-16 (Bankr. D. Mont. May 13, 2009).

895 *Id.* at *31.

896 *Id.*

897 *Id.* at *29, *32-*33.

898 308 U.S. 295 (1939).

invocation.[899] The issue in *Pepper* was whether a bankruptcy court could disallow (either as a secured or general unsecured claim) a judgment obtained by the dominant and controlling stockholder of a bankrupt corporation.[900] The defendant, the controlling stockholder of a "one-man" corporation, caused his corporation to confess judgment in his favor for allegedly unpaid salary at a time when that corporation faced financial difficulties.[901] The shareholder executed on his judgment and levied on property that he in turn sold to another corporation he controlled.[902] Thereafter, his corporation filed for bankruptcy. In holding that the lower court properly disallowed the shareholder's claim, the Court noted that, for many purposes, "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity."[903] Among the powers granted to bankruptcy courts as courts of equity is the allowance and disallowance of claims, and thus, "a bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence."[904] The Court explained that, particularly in cases when the claim sought to be allowed accrues to the benefit of an officer, director, or stockholder, claims have been disallowed or subordinated when the courts were satisfied that the allowance of the claims would not be fair

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899 *Id.* at 305 ("[A] claim which has been allowed may be later 'rejected in whole or in part, according to the equities of the case . . . .'") (quotation omitted).

900 *Id.* at 298.

901 *Id.* at 297.

902 *Id.* at 297-98.

903 *Id.* at 304.

904 *Id.* at 305 & 307-08 ("In the exercise of its equitable jurisdiction, the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankruptcy estate.").

or equitable to creditors.[905] Because the shareholder had engaged in a "planned and fraudulent scheme," disallowance of the shareholder's claim was warranted.[906]

Although *Pepper* is venerable authority that a court's equity powers include the power to disallow a claim on equitable bases, the question presented under the Bankruptcy Code is whether equitable disallowance contravenes the provisions of Bankruptcy Code section 510(c), which, as noted, specifies that equitable subordination entails adjusting priorities *among* creditors, but not *between* creditors and shareholders.[907] In the years since *Pepper*, courts in the Third Circuit have addressed this question but have not answered it. In *Equibank v. Dan-Ver Enterprises, Inc. (In re Dan-Ver Enterprises, Inc.)*, a judgment creditor filed an adversary complaint, claiming that judgments held by several individuals should be equitably subordinated to its own claim under Bankruptcy Code section 510(c).[908] In determining whether equitable subordination was appropriate, the United States Bankruptcy Court for the Western District of Pennsylvania explained that certain loans granted by the individuals were made to the debtor's CEO and president, and not to the debtor's estate.[909] Rather than subordinating such claims, the bankruptcy court, relying on the principles set forth in *Pepper*, disallowed the claims in their entirety.[910]

More recently, in *Citicorp Venture Capital, Ltd. v. Committee of Creditors Holding Unsecured Claims*, the Third Circuit Court of Appeals considered the question whether the

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905 *Id.* at 308-09.

906 *Id.* at 301, 302 & 312-13.

907 On the other hand, Bankruptcy Code section 502(j), like section 57(k) of the Bankruptcy Act, provides statutory authority to disallow a claim based on the "equities of the case." 11 U.S.C. § 502(j) (2006) ("A reconsidered claim may be allowed or disallowed according to the equities of the case.").

908 86 B.R. 443, 450 (Bankr. W.D. Pa. 1988).

909 *Id.*

910 *Id.* at 451-52.

claims of a creditor stemming from a leveraged buyout could be equitably subordinated in light of evidence that the creditor surreptitiously purchased outstanding notes before the plan confirmation date to obtain a "blocking position" in the proposed reorganization.[911] The court held that the creditor's claims could be equitably subordinated because the notes were purchased: (1) for the dual purpose of making a profit and influencing the reorganization in its own self-interest; (2) with the benefit of non-public information acquired as a fiduciary; and (3) without disclosure of the purchasing plans to the bankruptcy court, the debtor's board, the official committee of unsecured creditors, or the selling noteholders.[912] In so holding, the court noted the district court's view that it lacked authority to fashion a "disallowance remedy."[913] Commenting that it "d[id] not endorse that conclusion," the court explained that the rationale of *Pepper* suggests that under pre-Bankruptcy Code law, a bankruptcy court was authorized to disallow a portion of a fiduciary's claim when the disallowance would produce an equitable result.[914] The court found it unnecessary, however, to resolve whether equitable "disallowance" remains an available remedy under the Bankruptcy Code.[915]

Later, in *Congoleum Corp. v. Pergament (In re Congoleum Corp.)*, the issue of equitable disallowance was again raised when a debtor sought to avoid as preferential transfers and postpetition transfers liens and security interests granted to asbestos claimants.[916] On previous occasions, the debtor had entered into agreements to settle asbestos claims asserted against it by assigning to the claimants certain unidentified insurance proceeds or granting security interests in

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911 160 F.3d 982, 985 (3d Cir. 1998).

912 *Id.* at 987.

913 *Id.* at 991 n.7.

914 *Id.*

915 *Id.*

916 2007 Bankr. LEXIS 4357, at *6 (Bankr. D.N.J. Dec. 28, 2007).

certain insurance policy collateral.[917] The debtor sought to equitably disallow the settled claims under Bankruptcy Code section 510(c), arguing that this provision allows for equitable disallowance of claims under principles of equitable subordination.[918] The New Jersey Bankruptcy Court disagreed, explaining that equitable subordination and equitable disallowance are "two distinct concepts," and section 510(c) deals solely with equitable subordination.[919] Indeed, "[w]hile equitable disallowance is a means by which a claim may be invalidated, equitable subordination focuses on altering the order of payment of a claim, which in turn presupposes that a valid claim already exists."[920] The court referred to the Third Circuit's discussion of equitable disallowance in *Citicorp Venture Capital Ltd.* and concluded that it remains unclear whether equitable disallowance may be raised under section 510(c).[921] The court addressed appropriate treatment of the asbestos claimants' claims under principles of equitable subordination.[922] Whether or not equitable disallowance is available within the Third

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[917] *Id.* at *3 & *4.

[918] *Id.* at *32.

[919] *Id.* at *32, *33 ("To allow equitable disallowance under the guise of equitable subordination would be contradictory.").

[920] *Id.* at *32-33.

[921] *Id.* at *33-34.

[922] *Id.* at *33-34. The courts of the Second Circuit have also considered the viability of equitable disallowance as a remedy in bankruptcy proceedings. In *Adelphia Communications Corp.*, the bankruptcy court discussed equitable disallowance as a remedy, finding that disallowance "would be permissible in those extreme instances – perhaps very rare – where it is necessary as a remedy." *Adelphia Commc'ns Corp. v. Bank of Am., N.A. (In re Adelphia Commc'ns Corp.)*, 365 B.R. 24, 73 (Bankr. S.D.N.Y. 2007), *aff'd sub nom. Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 64 (S.D.N.Y. 2008), *aff'd*, 2010 WL 2094028 (2d Cir. May 26, 2010). In *Adelphia Communications Corp.*, the creditors' committee and equity committee asserted claims against lenders and investment banks, seeking to equitably subordinate and/or disallow the lenders' claims because the lenders had aided and abetted management in breaching its fiduciary duties and allowing constructively fraudulent transfers. *Adelphia Commc'ns Corp.*, 365 B.R. at 73. The court reasoned that although Bankruptcy Code section 510(c) expressly authorizes equitable subordination but does not likewise authorize equitable disallowance, it was not in a position to conclude that Congress intended to foreclose the possibility of disallowance in light of *Pepper* and its progeny. *Id.* at 73. The court also emphasized that subordination and disallowance were linked by an "or" no less than five times in the *Pepper* decision, showing that the Court perceived the remedies to be separate, distinct, and uniquely available. *Id.* Thus, although disallowance was "plainly" a "more draconian" remedy, it would be appropriate in "just a few" situations, and might be proper only when it represents the "most measured means" to correct the claimed inequity. *Id.* The court agreed that equitable disallowance was

Circuit, this remedy requires creditor misbehavior at least as repugnant as that which would warrant equitable subordination

3. Application of Legal Standards.

a. Examiner's Conclusions and Explanation Concerning LBO Lender Debt.

Examiner's Conclusions: Based on the evidence adduced in the Investigation, a court is somewhat unlikely to exercise its equitable discretion to subordinate the claims of the LBO Lenders in the Chapter 11 Cases pursuant to Bankruptcy Code section 510(c). However, for the reasons discussed below, the Examiner believes that additional investigation is warranted.

Explanation of Examiner's Conclusions:

Because the Lead Banks were not insiders of the Tribune Entities, they enjoy the benefit of the heightened standard required to equitably subordinate their claims.[923] Although the Examiner has found that it is reasonably likely that a court would find that the Lead Banks did not act in good faith for purposes of applying that defense to avoidance of the Step Two Debt, [924] lack of good faith for fraudulent transfer purposes is not synonymous with the kind of egregious behavior meriting equitable subordination. The question is whether the Lead Banks crossed the line into egregious behavior that would justify equitable subornation or equitable disallowance of the LBO Lender Debt.

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permissible under *Pepper*, and that the allegations in the complaint before it might support the equitable disallowance of the lenders' claims, if proven. *Id.* On appeal, the United States District Court for the Southern District of New York agreed with the bankruptcy court's conclusion that equitable disallowance was permissible under *Pepper*, noting that *Pepper* endorsed the use of equitable disallowance, not on the basis of any statutory language, but as an unspoken tenet of a bankruptcy court exercising its powers of equity. *Adelphia Recovery Trust*, 390 B.R. at 76; *see also Off. Comm. of Unsecured Creditors v. Morgan Stanley & Co. (In re Sunbeam Corp.)*, 284 B.R. 355, 369 n.3 (Bankr. S.D.N.Y. 2002) (declining to address the issue of the continued viability of equitable disallowance post-Bankruptcy Code, but observing that, to the extent equitable disallowance would apply, such disallowance would be based on the same equitable principles as equitable subordination).

[923] *See* Report at § IV.D.1.a.

[924] *See id.* at §§ IV.B.7.b.(2)–IV.B.7.b.(8).

Certain of the Parties pointed the Examiner to excerpts from the tens of thousands of documents generated or e-mails sent during the Leveraged ESOP Transactions allegedly supporting an inference that one or more of the Lead Banks acted improperly. The Examiner investigated and addresses as a factual matter in Volume One of the Report the allegations of wrongdoing levied by certain Parties against one or more of the Lead Banks.[925] The Examiner encourages the reader to review that narrative discussion. The Lead Banks came to the Leveraged ESOP Transactions with varying motivations, including to earn large fees, to foster relationships with the Zell Group and Tribune, and to deploy capital in the form of loans from which they hoped to profit by holding the loans for their own account or through syndication. More often than not, particularly as they relate to the Step One Transactions, the e-mails and documents cited by the Parties contained more smoke than fire. The record is clear that the lender-participants knew that the LBO Lender Debt would benefit from the structural seniority afforded by the Subsidiary Guarantees.[926] The corresponding result is that Tribune's creditors were structurally disadvantaged, but there was nothing per se improper about exploiting an opportunity presented by the Tribune Entities' capital structure and the absence of contractual prohibitions against the incurrence of debt at the Guarantor Subsidiary levels.[927] Likewise, there is plenty of evidence that one or more of the Lead Banks were concerned, before Step One, about the amount of leverage in the Zell transaction and, before Step Two, about the deterioration in

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925 *See id.* at §§ III.E.4. and III.H.4.

926 Examiner's Sworn Interview of Julie Persily, July 8, 2010, at 31:18-22-32:1 ("[M]eaning that one could layer as much debt as they want -- the PHONEs did not have protection in their document to prevent layering debt above them. Q: Okay. A: Which is unusual.").

927 *See* footnote 88 and accompanying text.

Tribune's operating performance and the corresponding level of leverage.[928] Healthy skepticism followed by due diligence is not a ground to equitably subordinate the Lead Bank's claims.

On the other hand, if the evidence showed that the Lead Banks knew that Step Two would render Tribune insolvent, but they proceeded to fund anyway, a case could be made for equitable subordination (and possibly equitable disallowance) not just of the Step Two Debt but, possibly, some or all of the remainder of the LBO Lender Debt.[929] There is evidence to suggest that the Lead Banks did not believe that VRC's solvency opinion was valid, but were mindful that even if VRC were wrong, the structural seniority enjoyed by the LBO Lenders over certain of Tribune's creditors afforded them a cushion. Thus, notes from a December 17, 2007 conference call among the Lead Banks reference a statement by a Citigroup representative, apparently in relation to VRC's solvency opinion: "S Corp savings WRONG but still +hv PHONES."[930] The internal valuation analyses prepared individually in-house by the Lead Banks in the November-December 2007 timeframe, discussed in another section of the Report,[931] suggest, in varying degrees, knowledge by those institutions that the Step Two Closing would render Tribune insolvent or very close to it. The notes taken by Daniel Petrik of BofA, also discussed elsewhere in the Report,[932] attribute to Merrill Lynch the view, expressed to the other Lead Banks three days before the Step Two Closing, that Merrill was leaning against funding and it was "[r]easonable that [Tribune was] not a solvent company."[933] The notes certainly

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928 *See* Report at §§ III.E.4. and III.H.4.

929 As discussed previously, equitable subordination does not require that the actions giving rise to subordination relate to the creditor's acquisition of its particular claim. *See* Report at § IV.D.1.

930 Ex. 890 (Handwritten Notes of JPMCB Representative). One might also be able to draw this inference from the various valuation analyses performed by certain LBO Lenders in December 2007. *See* Report at § III.H.4.b.

931 *See* Report at § III.H.4.b.

932 *Id.* at § III.H.4.b.(1).

933 Ex. 959 at BOA-TRB-0001201 (Petrik Handwritten Notes, dated December 14, 2007).

reflect that the Lead Banks were keenly focused on understanding "risk" if the banks did and did not fund.[934]

Although, as noted, there was no impropriety per se in taking advantage of the opportunity presented by the failure of Tribune's creditors to obtain recourse against the Guarantor Subsidiaries' assets, there would be something wrong if those institutions proceeded with the Step Two funding knowing that this would render Tribune insolvent. But why might the Lead Banks do that? At a superficial level, it would seem illogical that the Lead Banks would ever do that, but closer reflection suggests otherwise. Perhaps the Lead Banks determined, despite what they might have believed amongst themselves, that they simply could not prove that Tribune would be rendered insolvent, and that it was better to fund Step Two and risk bankruptcy litigation down the line than stain their reputations by not funding, rupture lending relationships with Tribune, EGI and Samuel Zell, and face a substantial lawsuit from Tribune and others right away. It is also possible that the Lead Banks concluded that the solvency question was close, but not sufficiently close to permit them to refuse to honor their contractual funding commitments, and that the S-Corporation/ESOP structure, combined with the Tribune Entities' catalogue of trophy assets and Mr. Zell's acumen, might enable the Tribune Entities to squeak by. Or perhaps they concluded that even if Step Two would render the Tribune Entities insolvent, sufficient value would be available at the Guarantor Subsidiaries, combined with their senior position in relation to the PHONES Notes, to make the banks whole, or close to it, while creditors and stakeholders would suffer the consequences. Or, more likely, perhaps they concluded that although incurrence of the Step Two Debt very likely would render Tribune insolvent (by mopping up the lion's share of Tribune's equity in the Guarantor

[934] *Id.*

Subsidiaries by the additional incurrence of $3.6 billion LBO Lender Debt at the Guarantor Subsidiary level), sufficient value still would be available from the Guarantor Subsidiaries to make the LBO Lenders whole even with the Step Two Debt added to the mix. In other words, whereas Tribune would be rendered insolvent and its creditors and new owner would suffer from the Step Two Closing, the Guarantor Subsidiary creditors (or which, as discussed at the outset of the Report, the LBO Lenders hold that vast portion of the claims) would recover in full.

The Investigation revealed that one or more of these scenarios may have served as possible motivations informing the Lead Banks' actions at Step Two, but the Investigation did not furnish sufficient proof on which conclusions could be reasonably drawn. Based on the record adduced through July 25, 2010, the Examiner has not found sufficient evidence to support a finding that the Lead Banks engaged in the kind of egregious behavior that would justify equitable subordination or equitable disallowance. In the Examiner's view, the fact that the Lead Banks had preexisting contractual funding obligations (entered into when the Tribune Entities probably were solvent) is a significant mitigating factor weighing against equitable subordination or equitable disallowance based on their acts.[935] The contractual baggage the Lead Banks carried as they approached Step Two adds nuance and complexity to their actions and makes it difficult for the Examiner to accept what is essentially the caricature that certain Parties portrayed to the Examiner of the Lead Banks' actions in the fall of 2007.[936]

The Lead Banks, however, represented by skilled counsel, plainly attempted to clothe as much of their deliberations as possible on this matter under the umbrella of attorney-client and

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[935] It should be noted, however, that consistent with the scope of the Investigation, which only includes estate claims or causes of action, the Examiner did not investigate any claims that individual creditors may hold against one or more of the Lead Banks. To be clear, the Examiner is not in any way addressing whether a fact or circumstance that serves to mitigate equitable subordination or equitable disallowance also would serve to mitigate, let alone have any relevance to, any such other potential claim or cause of action.

[936] To be clear, the Examiner finds separately that these circumstances were insufficient to give the Lead Banks a good faith defense under Bankruptcy Code section 548(c). *See* Report § IV.B.7.b.(3).

other privileges. Moreover, without casting aspersions, in their testimony before the Examiner, witnesses for the Lead Banks tended to speak from the same script in discussing key events as well as their activities during the months preceding the Step Two Closing. One witness professed to remember little or nothing at all about these events, at least during his sworn interview, despite documentary evidence suggesting that this witnesses' institution had very clear views on these matters.[937] At a minimum, the Examiner greeted portions of the testimony furnished by witnesses for the Lead Banks with a healthy dose of skepticism. The Examiner did not have an opportunity to pursue whether or to what extent the deliberations that the Lead Banks engaged in during the fall of 2007 actually are protected attorney-client communications or are really business discussions among principals, masquerading as communications to and from counsel and financial advisors. Further, to the extent the Lead Banks assert privilege based solely on the fact that an attorney was present during a telephone conference or meeting, or was copied on correspondence, any such assertions are highly suspect.[938] The Examiner also did not have an opportunity to interview all of the witnesses who might have shed light on the question of what the Lead Banks knew and said to one another leading to the Step Two Closing, to the extent contentions of privilege do not shield those communications. Further investigation therefore is merited.[939]

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[937] *See* footnotes 760 -761.

[938] *See Hoot Winc, LLC v. RSM McGladrey Fin. Process Outsourcing, LLC*, 2010 U.S. Dist. LEXIS 57880 (S.D. Cal. June 11, 2010) ("communications between corporate officers or employees transacting the general business of the company do not attain privileged status solely because in-house or outside counsel is 'copied in' on correspondence"); *Aetna Cas. & Sur. Co. v. Certain Underwriters at Lloyd's, London*, 176 Misc. 2d 605, 609 (N.Y. Sup. Ct. 1998) ("there is no privilege where the attorney is present at a meeting as 'a mere scrivener' and there is no consultation for legal advice"). *See generally Fisher v. United States*, 425 U.S. 391, 403 (1976) ("since the privilege has the effect of withholding relevant information from the factfinder, it applies only where necessary to achieve its purpose. Accordingly it protects only those disclosures – necessary to obtain informed legal advice – which might not have been made absent the privilege.").

[939] The production of documents furnished by BofA, discussed previously, *see* footnote 738, raise questions regarding whether (1) the redacted sections are, in fact, protected by any privilege that would prevent the use of such information by the Examiner, and (2) under applicable law, such privilege, if valid, was waived.

The Examiner acknowledges that if a court disagrees with his conclusions and finds cause for equitable subordination or equitable disallowance, or if new evidence supports such a finding, a court would have to grapple with the questions whether the acts of the Lead Banks may be attributed to all LBO Lenders for equitable subordination purposes and whether trading of LBO Lender Debt both before and after the Chapter 11 Cases gives rise to defenses to equitable subordination in the transferees' hands. The Examiner leaves those matters in equipoise.[940]

b. Examiner's Conclusions and Explanation Concerning EGI-TRB Note Claims.

Examiner's Conclusions: A court is reasonably unlikely to exercise its equitable discretion to subordinate the EGI claims in the Chapter 11 Cases pursuant to Bankruptcy Code section 510(c).

Explanation of Examiner's Conclusions:

The Examiner did not find any plausible basis in the record to justify equitable subordination of the EGI-TRB Notes, which is contractually subordinated to most indebtedness in any event. The Zell Group proposed an aggressive, highly-leveraged transaction that failed and ended up in bankruptcy. EGI lost a lot of money. These are not grounds to equitably subordinate the EGI-TRB Notes beyond their already broad contractual subordination.

Nevertheless, the Examiner's review of this production occurred at a time when these questions could not have been answered within the deadline set by the Bankruptcy Court for the filing of the Report.

Similarly, on or about July 13, 2010, counsel to JPM notified the Examiner that JPM had inadvertently produced certain records that are purportedly protected by the attorney/client privilege. JPM supplied the Examiner with redacted versions of those documents and asked the Examiner to return or destroy the unredacted versions of the same records. The JPM redacted records raise the same issues as Mr. Petrik's handwritten notes. For the very same reason, the Examiner did not raise these issues with the Court before filing his Report.

In light of the passage of the deadline for filing the Report, absent further order of the Court the Examiner currently does not intend to pursue these matters.

[940] *See* Report at § IV.B.7.b.(2).; s*ee also* footnote 882.

4. Examiner's Conclusions and Explanation Concerning Equitable Disallowance.

Examiner's Conclusions: A court is reasonably unlikely to equitably disallow the claims of EGI under the EGI-TRB Notes and is somewhat unlikely to equitably disallow the LBO Lender Debt based on any actions by the Lead Banks in connection with the Step Two Transactions.

Explanation of Examiner's Conclusions:

The Examiner reaches these conclusions for the same reasons as his conclusions on the question of equitable subordination.

E. Common Law Claims.

1. Examiner's Conclusions and Explanation Concerning Choice of Law/Choice of Forum Issues Presented by Common Law Claims.

Examiner's Conclusions:

As a threshold matter in evaluating the various common law claims and defenses asserted by the Parties, the Examiner determined the law applicable to each claim. The Examiner applied the choice of law rules of the State of Delaware, as the forum state,[941] and also considered any choice of law arguments raised by the Parties. The Examiner's conclusions regarding the law applicable to each common law claim are set forth below.[942]

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[941] *See Charan Trading Corp. v. Uni-Marts, LLC (In re Uni-Marts, LLC)*, 399 B.R. 400, 414 n.4 (Bankr. D. Del. 2009) (*citing Pickett v. Integrated Health Servs., Inc. (In re Integrated Health Servs., Inc.)*, 304 B.R. 101, 106 (Bankr. D. Del. 2004), *aff'd*, 233 F. App'x 115 (3d Cir. 2007)).

[942] No Party argued that any of the common law claims addressed in the Report should or would be commenced in a forum other than the Bankruptcy Court. Consistent with the scope of the Investigation, therefore, the Examiner assumes that any such claims would be brought in that court.

Explanation of Examiner's Conclusions:

a. Breach of Fiduciary Duty.

The Examiner concludes that a court is highly likely to apply Delaware law in evaluating any claim for breach of fiduciary duty.[943] By incorporating in Delaware, an entity submits to the application of Delaware law for the governance of the corporation's internal affairs, including the nature and scope of the fiduciary duties owed by the corporation's directors and officers.[944] Tribune is a Delaware corporation with its corporate headquarters located in Illinois.[945] Delaware law, therefore, governs the fiduciary duties of the Company's officers, directors and controlling shareholders.[946] Delaware law likewise governs the fiduciary duties of the officers and directors of those Subsidiary Guarantors incorporated in Delaware.[947]

b. Aiding and Abetting Breach of Fiduciary Duty.

In evaluating any claim for aiding and abetting breach of fiduciary duty, the Examiner concludes that a court is highly likely to apply Delaware law, with additional reference to the law

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943 Certain Parties contended that breach of fiduciary duty claims can be asserted against the officers and directors of Tribune, the officers and directors of the Subsidiary Guarantors, the Large Stockholders, and the Zell Group. All Parties applied Delaware law in their analyses of breach of fiduciary duty claims without addressing whether another state's law could or should apply.

944 *See Teleglobe Commc'ns Corp. v. BCE, Inc. (In re Teleglobe Commc'ns Corp.)*, 493 F.3d 345, 386 (3d Cir. 2007) ("Under the internal affairs doctrine, anyone controlling a Delaware corporation is subject to Delaware law on fiduciary obligations to the corporation and other relevant stakeholders."); *In re Topps Co. S'holders Litig.*, 924 A.2d 951, 960 (Del. Ch. 2007) (Strine, V.C.) (explaining that the law of fiduciary obligations is one of the most important ways a state regulates a corporation's internal affairs); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 306 (1971).

945 Ex. 4 at 1 (Tribune 2007 Form 10-K).

946 *See Topps Co. S'holders Litig.*, 924 A.2d at 959-60 (describing Delaware's "compelling public policy interest" in regulating the internal affairs of Delaware corporations by establishing the parameters of the fiduciary duties of directors).

947 Although several Parties noted the possibility of claims for breach of fiduciary duty against officers and directors of Subsidiary Guarantors, the only director of a Subsidiary Guarantor actually identified as a potential target of such a claim was David Williams, who served as a director of TMS Entertainment Guides, Inc. and Tribune Media Services, Inc. at the closing of Step One and Step Two. *See* Ex. 967 (Subsidiary Board Member Chart). TMS Entertainment Guides, Inc. and Tribune Media Services, Inc. are both incorporated in Delaware.

of Illinois.[948] Delaware has adopted the "most significant relationship" test set forth in the Restatement (Second) of Conflict of Laws for analyzing the law applicable to tort claims.[949] The most significant relationship test provides that "[t]he rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence and the parties."[950] In making this evaluation, a court must take into account:[951]

> (a) the place where the injury occurred,
>
> (b) the place where the conduct causing the injury occurred,
>
> (c) the domicil, residence, nationality, place of incorporation and place of business of the parties; and
>
> (d) the place where the relationship, if any, between the parties is centered.

Here, the Tribune Board often convened in person in Chicago, Illinois, with the Financial Advisors in attendance.[952] The Company's headquarters also are located in Illinois, and various

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[948] The Parties argued that claims for aiding and abetting breach of fiduciary duty can be asserted against the Large Stockholders, the LBO Lenders, the Financial Advisors, the Zell Group, and the officers and directors of Tribune and the Subsidiary Guarantors. Most of the Parties applied Delaware law in their analyses of aiding and abetting breach of fiduciary duty claims without addressing whether another state's law could or should apply. Two Parties, in their reply briefs, cited to authorities in multiple jurisdictions but did not address choice of law.

[949] *See Travelers Indem. Co. v. Lake*, 594 A.2d 38, 46-47 (Del. 1991) (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 6, 145 (1971)). In adopting the Restatement, the *Travelers* court overruled the law of Delaware which, to that point, had utilized the *lex loci delicti* rule. *Travelers Indem. Co.*, 594 A.2d at 46-47.

[950] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(1) (1971). When there is no statutory directive, the factors relevant to the choice of the applicable rule of law include: (a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability, and uniformity of result, and (g) ease in the determination and application of the law to be applied. *Id.* § 6(2).

[951] *Travelers Indem. Co.*, 594 A.2d at 47; *see* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145 (1971). These contacts are to be evaluated according to their relative importance with respect to the particular matter at issue.

[952] *See* Ex. 93 at TRB0434048 (Tribune Board Meeting Minutes, dated September 21, 2006) (reflecting meeting held at Tribune Tower); Ex. 94 at TRB0434065 (Tribune Board Meeting Minutes, dated October 18, 2006) (same); Ex. 246 at TRB0434077 (Tribune Board Meeting Minutes, dated December 12, 2006) (same); Ex. 67 at TRB0415614 (Tribune Board Meeting Minutes, dated February 13, 2007) (same); Ex. 643 at TRB0415663 (Tribune Board Meeting Minutes, October 17, 2007) (same); Ex. 727 at TRB0415676 (Tribune Board Meeting

events relating to the Leveraged ESOP Transactions transpired in Illinois.[953] On this basis, one Party suggested that Illinois law should govern an aiding and abetting fiduciary duty claim. The relevant contacts point to Delaware and Illinois, but do not weigh heavily in favor of applying the law of either jurisdiction.[954] The Examiner need not decide this issue, however, because the elements of aiding and abetting breach of fiduciary duty are substantially similar under Delaware and Illinois law.[955] In these circumstances, when there is no actual conflict between the laws of the different jurisdictions, a choice of law analysis under Delaware's most significant relationship test is unnecessary.[956] Instead, the Examiner may apply the law of the forum state[957] or refer to

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Minutes, dated December 4, 2007) (same); Ex. 11 at TRB0415683 (Tribune Board Meeting Minutes, dated December 18, 2007) (same).

953 *See* Ex. 4 at 1 (Tribune 2007 Form 10-K); *see also* Report at §§ III.A.1 and III.D.16.

954 *See LaSala v. Bordier et Cie*, 519 F.3d 121, 130-32 (3d Cir. 2008) (holding, under Delaware law, that a complaint sufficiently alleged harm to a Delaware corporation in Delaware arising from an alleged breach of the duty of loyalty by the corporation's directors that led to bankruptcy). No Party argued for the application of New York law to aiding and abetting breach of fiduciary duty claims, and, as such, the Examiner did not evaluate whether New York law should apply. *See In re Am. Int'l Grp., Inc. Consol. Derivative Litig.*, 976 A.2d 872, 882 & n.17 (Del. Ch. 2009) (applying Delaware law, as the law of the forum state, when the parties "tacitly concede[d] that Delaware law is applicable" by failing to brief the issue whether another state's law should apply).

955 *Compare Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1038-39 (Del. Ch. 2006) (observing that a plaintiff pleading an aiding and abetting breach of fiduciary duty claim must prove "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty and (3) knowing participation in that breach by the nonfiduciary") (citing *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 72 (Del. 1995)), *with Hefferman v. Bass*, 467 F.3d 596, 601 (7th Cir. 2006) (stating, in evaluating viability of aiding and abetting breach of fiduciary duty claim, that "[u]nder Illinois law, to state a claim for aiding and abetting, one must allege (1) the party whom the defendant aids performed a wrongful act causing an injury, (2) the defendant was aware of his role when he provided the assistance, and (3) the defendant knowingly and substantially assisted the violation") (*citing Thornwood, Inc. v. Jenner & Block*, 799 N.E.2d 756, 767 (Ill. App. Ct. 2003)).

956 *See Kronenberg v. Katz*, 872 A.2d 568, 589 (Del. Ch. 2004) ("Where the choice of law would not influence the outcome, the court may avoid making a choice.") (footnote omitted); *see also Pa. Emp. Benefit Trust Fund v. Zeneca*, 2010 U.S. Dist. LEXIS 44413, at *12-14 (D. Del. May 6, 2010) (collecting cases concluding that if no actual conflict exists upon examination of competing laws proposed by the parties, there is a "false conflict" and no choice of law analysis is necessary).

957 *See Zeneca*, 2010 U.S. Dist. LEXIS 44413, at *46 n.9 (noting that defaulting to the law of the home forum in the event of a false conflict "is another way of stating that applying the law of the foreign jurisdiction is unnecessary as the substance of the law is consistent with the home forum"); *cf. Eckmar Corp. v. Malchin*, 297 A.2d 446, 449 (Del. Ch. 1972) (choosing to apply Delaware law, as the law of the forum, where defendant argued that New York law should apply but "made no record showing that New York law is any different than our own").

the laws of both states interchangeably in addressing the Parties' claims of aiding and abetting breach of fiduciary duty.[958]

c. Unjust Enrichment.

In evaluating any claim for unjust enrichment, the Examiner concludes that a court is highly like to apply Delaware law, with additional reference to the law of Illinois.[959] Delaware courts use the most significant relationship test to determine the law applicable to restitution claims.[960] In the context of such a claim, the courts evaluate contacts including (a) the place where a relationship between the parties was centered, provided that the receipt of enrichment was substantially related to the relationship; (b) the place where the benefit or enrichment was received; (c) the place where the act conferring the benefit or enrichment was done; (d) the domicile, residence, nationality, place of incorporation, and place of business of the parties; and (e) the place where a physical thing, such as land or chattel, which was substantially related to the enrichment, was situated at the time of the enrichment.[961]

Certain Parties asserted that based upon this analysis, Illinois law should apply. As in the case of aiding and abetting claims, however, the relevant contacts point to the application of

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[958] *See Zeneca*, 2010 U.S. Dist. LEXIS 44413, at *44-*46 (collecting cases holding that when a "false conflict" exists, the court is free to refer to the laws of the competing jurisdictions interchangeably).

[959] Certain Parties that addressed the choice of law issue with respect to an unjust enrichment claim argued that Illinois law should apply. Other Parties contended that a choice of law analysis was unnecessary because unjust enrichment claims are preempted.

[960] *See Landis v. Sci. Mgmt. Corp.*, 1991 Del. Ch. LEXIS 19, at *8 (Del. Ch. Ct. Feb. 15, 1991) ("The first step in the analysis of the unjust enrichment claim is to determine the appropriate choice of law. Delaware follows the 'most significant relationship' test of the Restatement (Second) of Conflict of Laws § 221 (1971) to determine the law applicable to unjust enrichment claims.") (citing *Hurst v. Gen. Dynamics Corp.*, 583 A.2d 1334, 1338 (Del. Ch. 1990)).

[961] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 221 (1971). These contacts are to be evaluated according to their relative importance with respect to the particular issue.

Delaware and Illinois law, with neither jurisdiction heavily favored.[962] In any event, the Examiner need not decide this issue because the elements of unjust enrichment are substantially similar under Delaware and Illinois law.[963] Because there is no actual conflict between the laws of the different jurisdictions, a choice of law analysis under Delaware's most significant relationship test is unnecessary.[964] Instead, as with the aiding and abetting claims, the Examiner concludes that a court is highly likely to apply Delaware law[965] or refer to the laws of Delaware and Illinois interchangeably in considering the Parties' unjust enrichment claims.[966]

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[962] No Party proposed that New York law should apply to unjust enrichment claims. The Examiner, therefore, did not evaluate the application of New York law. *See In re Am. Int'l Group, Inc. Consol. Derivative Litig.*, 976 A.2d 872, 882 & n.17 (Del. Ch. 2009).

[963] *Compare Rosener v. Majestic Mgmt., Inc. (In re OODC, LLC)*, 321 B.R. 128, 145 (Bankr. D. Del. 2005) ("To support a claim for unjust enrichment, the plaintiff must establish that the defendant received a benefit, that the defendant was aware of the benefit, and that the benefit was accepted by the defendant under circumstances that would make the acceptance inequitable without payment for its value."), *and Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 393 (Del. Ch. 1999) (stating that unjust enrichment is the "unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity or good conscience") (quotations & citations omitted), *with Vinarov v. Motorola, Inc.*, 2008 U.S. Dist. LEXIS 25363, at *39 (N.D. Ill. Mar. 26, 2008) ("The essential elements of a claim for unjust enrichment include plaintiff conferring a benefit on defendant, defendant accepting that benefit, and circumstances where defendant's retention of the benefit 'violates fundamental principles of justice, equity, and good conscience.'") (quoting *Johnson v. Gudmundsson*, 35 F.3d 1104, 1114 (7th Cir. 1994)), *and Douglass v. Wones*, 458 N.E.2d 514, 521 (Ill. App. Ct. 1983) (stating that unjust enrichment consists of the "unjust retention of a benefit . . . by one party to the detriment of another party, against the fundamental principles of justice, equity, and good conscience") (citation omitted).

[964] Indeed, the one Party that argued that Illinois law should apply acknowledged that the relevant principles underlying the doctrine of unjust enrichment are the same under Delaware and Illinois law. *See also Kronenberg*, 872 A.2d at 589; *see also Zeneca*, 2010 U.S. Dist. LEXIS 44413, at *12-14. *Cf. Phoenix Canada Oil Co. Ltd. v. Texaco Inc.*, 560 F. Supp. 1372, 1379-83 (D. Del. 1983) (applying "most significant relationship" test to determine law applicable to unjust enrichment claim where actual conflict existed between the laws of New York and Ecuador), *aff'd in relevant part, vacated in part on other grounds*, 842 F.2d 1466, 1473 (3d Cir. 1988).

[965] *See Zeneca*, 2010 U.S. Dist. LEXIS 44413, at *12-14.

[966] *See id* at *46 n.9.

d. Illegal Corporate Distributions.

In evaluating any claim arising under the Delaware General Corporation Law, the Examiner concludes that it is highly likely (if not certain) that a court will, by definition, apply Delaware law.[967]

e. Professional Malpractice Claims.

In evaluating a professional malpractice claim, the Examiner concludes that it is highly likely a court will apply the law of Illinois.[968]

Under Delaware choice of law principles, when parties have designated in their contract the law applicable to disputes under that contract, such a provision "must be respected as long as the law selected 'bears some material relationship to the transaction.'"[969] "When the fact of Delaware incorporation has no bearing on the parties' relationship, and they have agreed to a broad choice of law provision that logically governs the claims brought before a Delaware court and that selects another state's law to govern," a Delaware court must apply the law selected in the parties' agreement.[970]

The VRC engagement letter selected Illinois law as the governing law for "[t]his agreement and any claim related directly or indirectly to this agreement (including any claim concerning advice provided pursuant to this agreement) . . . ."[971] No Party argued that the fact of

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967 *See* DEL. CODE ANN. tit. 8, § 160(a)(1) (2010). Certain of the Parties raised statutory claims under the Delaware General Corporation Law challenging the legality of Tribune's purchase or redemption of its own stock or payment of dividends as illegal corporate distributions.

968 According to one of the Parties, the Debtors have a strong claim against VRC under Illinois law for negligence or professional malpractice arising from VRC's work on its solvency opinions. Another Party briefly addressed the possibility of professional malpractice claims against VRC or other advisors to the Company, citing cases in the federal district courts of Texas and New York, but did not address the question of which state's law should apply.

969 *Weil v. Morgan Stanley DW Inc.*, 877 A.2d 1024, 1032 (Del. Ch. 2005) (quoting *Annan v. Wilmington Trust Co.*, 559 A.2d 1289, 1293 (Del. 1989)).

970 *Weil*, 877 A.2d at 1035.

971 Ex. 267 at Ex. 1 (VRC Solvency Engagement Letter, dated April 11, 2007).

the Company's Delaware incorporation bears on the contractual relationship between Tribune and VRC. Likewise, no Party disputed the efficacy of the choice of law provision in the VRC engagement letter.[972] Moreover, the Examiner finds that the choice of law provision in the VRC engagement letter is framed in terms that are sufficiently broad to encompass a claim of professional malpractice against VRC.[973] Thus, the Examiner will apply Illinois law to evaluate potential professional malpractice claims against VRC.

2. Breach of Fiduciary Duty.

a. Legal Standard for Breach of Fiduciary Duty Claims.

It is a fundamental principle of Delaware law that the business and affairs of a corporation are managed by or under the direction of its board of directors.[974] With this power comes "certain fundamental fiduciary obligations to the corporation and its shareholders."[975] In their management of the corporation, "directors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders."[976] The appropriate discharge of this obligation will "depend[] upon the specific context that gives occasion to the board's exercise of its business judgment."[977] The fiduciary duties of directors

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[972] *See Edelist v. MBNA Am. Bank*, 790 A.2d 1249, 1255-56 (Del. Super. Ct. 2001) (analyzing "most significant relationship" factors when plaintiff disputed the effectiveness of a choice of law provision in defendant's credit card agreement, and concluding that choice of law clause was effective).

[973] Ex. 267 at Ex. 1 (VRC Solvency Engagement Letter, dated April 11, 2007).

[974] *See* DEL. CODE ANN. tit. 8, § 141(a) (2010) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); *see also Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 366 (Del. 2006); *McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2000) (citations omitted).

[975] *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (footnote omitted), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) [hereinafter, *Brehm I*].

[976] *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1994); *see also N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) (stating that "fiduciary duties of the directors of a Delaware corporation are unremitting").

[977] *McMullin*, 765 A.2d at 918.

extend even after they resign from the board of directors,[978] and can compel them to oppose a transaction, even when there is a slight conflict of interest.[979]

Officers of Delaware corporations owe fiduciary duties identical to those of directors.[980] Moreover, fiduciary duties extend to any shareholder who exercises "a 'dominant' position and/or actually 'controlled' the corporation's conduct."[981] Thus, a shareholder who owns a majority interest in, or exercises control over the business and affairs of, the corporation owes fiduciary duties to minority shareholders.[982]

(1) The Business Judgment Rule and the Entire Fairness Doctrine.

The business judgment rule embodies the "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest

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978 *FDIC v. Barton*, 1998 U.S. Dist. LEXIS 5203, at *19-22 (E.D. La. Apr. 8, 1998).

979 *Dalton v. Am. Inv. Co.*, 1981 Del. Ch. LEXIS 647, at *2-7 (Del. Ch. June 4, 1981).

980 *Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009).

981 *See Rosener v. Majestic Mgmt., Inc. (In re OODC, LLC)*, 321 B.R. 128, 142 (Bankr. D. Del. 2005). The concepts of "dominance" and "control" are given their "ordinary meaning," and, "at a minimum . . . imply (in actual exercise) a direction of corporate conduct in such a way as to comport with the wishes or interest of the corporation (or persons) doing the controlling." *Id.* (quotations & citation omitted).

982 *See Kahn v. Lynch Commc'ns. Sys., Inc.*, 638 A.2d 1110, 1113-14 (Del. 1994). Generally, a shareholder who owns less than 50% of a corporation's outstanding stock does not, without more, owe fiduciary duties. *See Gilbert v. El Paso Co.*, 490 A.2d 1050, 1055 (Del. Ch. 1984) (citing *Osofsky v. J. Ray McDermott & Co.*, 725 F.2d 1057 (2d Cir. 1984)). Rather, "[f]or a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporat[e] conduct." *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989); *see also Kahn*, 638 A.2d at 1114-15 (46% shareholder found to be controlling on the basis of several facts, including that shareholder designated directors to five of the eleven board seats); *Solomon v. Armstrong*, 747 A.2d 1098, 1117 n.61 (Del. Ch. 1999) (stating that domination requires "literal control of corporate conduct"), *aff'd*, 746 A.2d 277 (Del. 2000); *Kaplan v. Centex Corp.*, 284 A.2d 119, 122 (Del. Ch. 1971); *see also In re W. Nat'l Corp. S'holders Litig.*, 2000 Del. Ch. LEXIS 82, at *25 (Del. Ch. May 22, 2000) (finding a shareholder to be non-controlling on the basis of several factors, including that none of the shareholder's "managers, employees, agents, or even nominees sat on [the allegedly controlled entity's] board of directors"); *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 913 (Del. Ch. 1999) (finding a 49% shareholder to be a controlling shareholder on the basis of several facts, including that two of the four directors of the controlled entities had conflicts of interest in the challenged transaction). In this regard, courts have held that designation of directors to the board of directors or entering into business agreements with an investee is not sufficient shareholder conduct, without more, to trigger a finding of "controlling" status; it is likewise insufficient to allege that shareholders were part of a "controlling group" because they had "parallel interests." *See Williamson v. Cox Commc'ns, Inc.*, 2006 Del. Ch. LEXIS 111, at *23 (Del. Ch. June 5, 2006) (citing *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 550-51 (Del. Ch. 2003)); *see also Kennedy v. Venrock Assocs.*, 348 F.3d 584, 590-91 (7th Cir. 2003).

belief that the action taken was in the best interests of the company."[983] This presumption attaches to "a director-approved transaction within a board's conferred or apparent authority in the absence of any evidence of 'fraud, bad faith, or self-dealing in the usual sense of personal profit or betterment.'"[984] The presumption strongly favors the actions taken by directors, such that a court will not "substitute its judgment for that of the board if the [board's] decision can be attributed to any rational business purpose."[985] Instead, when the business judgment rule's presumption applies, "a corporate officer or director is not legally responsible to the corporation for losses that may be suffered as a result of a decision that an officer made or that directors authorized in good faith."[986] The rule thus achieves two salutary ends: it avoids judicial intervention "into a management role for which [the courts] were neither trained nor competent," and it shields entrepreneurial and even risky decisions, provided those decisions were made with due care and in good faith.[987]

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983 *McMullin*, 765 A.2d at 916 (quotations & citations omitted); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

984 *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1994) (citation omitted); *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989) (citations omitted).

985 *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (quoting *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954 (Del. 1985)); *see also Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537, 549 (D. Del. 2005) *aff'd*, 278 F. App'x 125 (3d Cir. 2008). One way to show that a decision cannot "be attributed to any rational business purpose" is to establish waste. *See Brehm v. Eisner (In re Walt Disney Co. Deriv. Litig.)*, 906 A.2d 27, 73-74 (Del. 2006) [hereinafter *Brehm II*]. Waste is rarely found in Delaware, however, as the standard imposes the heavy burden to demonstrate "the rare, unconscionable case where directors irrationally squander or give away corporate assets." *Id.* at 74 (quotations & citations omitted). In these Chapter 11 Cases, no Party has alleged waste.

986 *See Continuing Creditors' Comm. of Star Telecommc'ns, Inc. v. Edgecomb*, 385 F. Supp. 2d 449, 458 (D. Del. 2004) (quotations & citations omitted); *see also Cede & Co.*, 634 A.2d at 361 (noting that when business judgment rule attaches, "our courts will not second-guess these business judgments").

987 *See Edgecomb*, 385 F. Supp. 2d at 458; *see also Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 193 (Del. Ch. 2006) ("The business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit."), *aff'd sub. nom Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007); *McMullin*, 765 A.2d at 916 ("The business judgment rule . . . combines a judicial acknowledgement of the managerial prerogatives that are vested in the directors of a Delaware corporation by statute with a judicial recognition that the directors are acting as fiduciaries in discharging their statutory responsibilities to the corporation and its shareholders.") (citations omitted); *Cede & Co.*, 634 A.2d at 360 ("The rule operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation."); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) ("The business judgment rule is an acknowledgement of the managerial prerogatives of Delaware directors . . . .").

The presumption erected by the business judgment rule is rebuttable. The burden of rebuttal lies initially with the contesting plaintiff who must demonstrate that the directors, in reaching the decision under attack, "breached any one of the triads of their fiduciary duty – good faith, loyalty or due care."[988] If the contesting plaintiff is unable to carry this burden, "the business judgment rule attaches to protect corporate officers and directors and the decisions they make."[989] Conversely, if the plaintiff succeeds in carrying this burden, the business judgment rule presumption falls away[990] and "the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff."[991]

"Entire fairness" is an "unflinching" inquiry[992] that requires the contested transaction to be a product of both fair dealing and fair price.[993] Fair dealing embraces "questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and

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[988] *Cede & Co.*, 634 A.2d at 361; *accord Brehm II*, 906 A.2d at 52; *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000); *Aronson*, 473 A.2d at 812. Note, however, that the Supreme Court of Delaware has since instructed that the first component of this triad, the duty of good faith, is subsumed under the duty of loyalty. *See Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006). *See* Report at § IV.E.2.a.(2).

[989] *Cede & Co.*, 634 A.2d at 361; *see McMullin*, 765 A.2d at 917 (noting that if it attaches, the rule "operates to protect the individual director-defendants from personal liability for making the board decision at issue") (citation omitted).

[990] Successfully rebutting the business judgment rule presumption "does not create *per se* liability on the part of the directors." *McMullin*, 765 A.2d at 917 (emphasis added). It merely shifts the burden back to the directors to substantively defend their actions. *Id.*

[991] *Cede & Co.*, 634 A.2d at 361; *accord Brehm II*, 906 A.2d at 52; *McMullin*, 765 A.2d at 917. Note that the use of a special committee can operate to shift the burden of proving entire fairness back onto the plaintiff or accusing party. *See In re Tele-Commc'ns, Inc. S'holders Litig.*, 2005 Del. Ch. LEXIS 206, at *33 (Del. Ch. Dec. 21, 2005). The party accused of breaching a fiduciary duty must, however, show that the special committee "was truly independent, fully informed, and had the freedom to negotiate at arm's length." *Id.* at *33. *Accord In re Cox Radio, Inc. S'holders Litig.*, 2010 Del. Ch. LEXIS 102, at *43 (Del. Ch. May 6, 2010) (same). If this test cannot be met, then the burden will not shift and will remain with the party accused of breaching a fiduciary duty. *See In re Tele-Commc'ns., Inc. S'holders Litig.*, 2005 Del. Ch. LEXIS 206, at *33.

[992] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983).

[993] *Cede & Co.*, 634 A.2d at 361; *Weinberger*, 457 A.2d at 711; *Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537, 549 (D. Del. 2005) *aff'd*, 278 F. App'x 125 (3d Cir. 2008).